COPY

BEFORE THE

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS SUCCESSOR TRUSTEE OF A PUBLIC CHARITABLE TRUST, D/B/A CITIZENS THERMAL ENERGY FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR STEAM UTILITY SERVICE, (2) APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, (3) APPROVAL OF CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR STEAM SERVICE, (4) APPROVAL OF NEW DEPRECIATION ACCRUAL RATES, AND (5) APPROVAL FOR THE QUARTERLY FILING OF FUEL COST ADJUSTMENT APPLICATIONS.	)	CAUSE NO. 43201

DIRECT TESTIMONY AND EXHIBITS OF

CAREY B. LYKINS
WILLIAM A. TRACEY
JAMES O. DILLARD
JOHN R. BREHM
and
MICHAEL D. STROHL

On Behalf of Petitioner,
Citizens Thermal Energy

Volume I

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April 2, 2007

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DIRECT TESTIMONY AND EXHIBITS
of
CAREY B. LYKINS

On
Behalf of
Petitioner

Citizens Thermal Energy

Petitioner's Exhibit CBL

INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Carey B. Lykins. My business address is 2020 North Meridian Street, Indianapolis, Indiana.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Board of Directors for Utilities (the "Board") of the Department of Public Utilities (the "Department") of the City of Indianapolis (the "City"). The City is the successor trustee of a public charitable trust and acting through the Board manages and controls a number of businesses, including the municipally-owned steam utility of Citizens Thermal Energy that I will refer to as the Steam System. I serve as the President and Chief Executive Officer of the municipal utilities and businesses under the Board's control.

Q. PLEASE GENERALLY DESCRIBE YOUR DUTIES AND RESPONSIBILITIES AS PRESIDENT AND CHIEF EXECUTIVE OFFICER.

A. I have broad responsibility for developing, coordinating and managing the implementation of long-term strategic objectives for the businesses that the Board is entrusted with managing and controlling, including the Steam System.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. In 1973, I received the degree of Bachelor of Science in Finance from Indiana University. I received the degree of Master of Business Administration from

Indiana University in 1981. In May 2003, I completed the Advanced Executive Program at Northwestern University's Kellogg School of Management. I am a Certified Public Accountant.

I began my employment with the Board in 1973 and progressed through positions of increasing responsibility in Customer Services, Rates and Finance. I served as Vice President of Customer Services and Rates from June 1990 to July 1994 and as Vice President of Customer Services and Finance from July 1994 to December 1997. In December 1997, I became Vice President and Chief Financial Officer. I was promoted to Senior Vice President and Chief Financial Officer in January 2000 and held that position until March 2003, when I was appointed Executive Vice President and Chief Operating Officer. I was named President and Chief Executive Officer in October 2005.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes. I have testified before this Commission in a number of proceedings, including Cause No. 41716, the proceeding in which this Commission approved the Board's acquisition of the Steam System.

Q. ARE YOU GENERALLY FAMILIAR WITH THE BUSINESS, PROPERTIES AND FINANCIAL CONDITION OF THE STEAM SYSTEM?

A. Yes, I am.

Q. HAVE YOU READ THE VERIFIED PETITION CITIZENS THERMAL ENERGY FILED INITIATING THIS PROCEEDING?

A. Yes. I have read the Verified Petition and am familiar with its contents. A copy of the Verified Petition is attached as Petitioner's Exhibit CBL-1.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. My testimony provides information in support of the relief requested by Petitioner in the December 29, 2006, Petition initiating this proceeding. My testimony first provides an overview of the Board, the public charitable trust it is entrusted with managing and the municipal steam utility of Citizens Thermal Energy, which is the Petitioner in this proceeding. Next, I will discuss the need for the rate relief requested and provide an overview of the testimony of the other witnesses who are testifying on behalf of Citizens Thermal Energy in this proceeding.

Q. PLEASE SUMMARIZE THE RELIEF CITIZENS THERMAL ENERGY IS REQUESTING.

A. Citizens Thermal Energy is seeking approval to increase its base rates and charges for steam service. The overall increase will be implemented in two phases. The proposed phase one rates and charges are designed to produce additional annual operating revenues of $6,753,988. Those additional operating revenues are needed to provide the Steam System income sufficient to maintain its utility property in a sound physical and financial condition to render adequate and efficient service. In addition, Citizens Thermal Energy requests a phase two base rate increase effective December 1, 2008, to recover an additional $3,062,670 to be coincident with the effective date of a Steam Purchase Agreement approved by

the Commission in its December 28, 2006, Order in Cause No. 43025. Citizens Thermal Energy also is requesting approval of revisions to its depreciation accrual rates for its steam utility plant in accordance with a depreciation study submitted with its case-in-chief testimony. Finally, Citizens Thermal Energy is requesting approval to change the frequency of its Steam System fuel cost adjustment filings from an annual to a quarterly basis.

OVERVIEW OF THE BOARD AND PUBLIC CHARITABLE TRUST

Q. PLEASE DESCRIBE THE BOARD.

A. The Board is the governing body of the Department, which is an executive department of the City of Indianapolis. The powers of the Board are set forth in Indiana Code Section 8-1-11.1-3. Pursuant to those statutory powers, the Board currently operates two municipally-owned utilities, the Steam System and Citizens Gas & Coke Utility.

Q. PLEASE DESCRIBE THE PUBLIC CHARITABLE TRUST FOR WHICH THE DEPARTMENT, ACTING THROUGH THE BOARD, SERVES AS SUCCESSOR TRUSTEE.

A. In 1887, a group of Indianapolis citizens created a gas company to operate as a public charitable trust, solely for the benefit of the City and its inhabitants and to resist a threatened monopoly and predatory pricing by a privately-owned company. The citizens who founded that company believed the public charitable trust would remain viable throughout the years and continue to deliver low-cost, high-value and excellent-quality energy services to the City and its inhabitants.

The "Citizens Gas Company of Indianapolis" was created in 1906 to succeed the original gas company and serve as trustee of what is now referred to as the public charitable trust. The City of Indianapolis replaced the Citizens Gas Company of Indianapolis as successor trustee of the trust in 1935 and, acting by and through the Board, continues to fulfill the purposes for the creation of the public charitable trust, which include supplying heat, light and power to the City and its inhabitants.

Q. PLEASE DESCRIBE THE GOVERNANCE STRUCTURE OF THE BOARD.

A. The Board is made up of seven persons who are selected and appointed annually by a five-member board of trustees. Each trustee serves a four-year term after being nominated by the board of trustees and appointed by the Mayor of the City of Indianapolis. Each person serving on the Board and the board of trustees must be at least 35 years of age and a resident of the City for at least five years preceding his or her appointment.

Q. TO WHOM ARE THE BOARD OF TRUSTEES AND BOARD ACCOUNTABLE?

A. Because of the unique structure of the public charitable trust, the board of trustees and the Board are accountable to a number of different entities in a number of ways. The Mayor or City-County Council of Indianapolis may seek to remove any trustee from office for neglect of duty, incompetence, disability to perform his or her duties or other good cause. Directors serving on the Board may be

removed summarily at any time by the board of trustees. The Board must make quarterly reports to the City Controller of all funds it receives and expends. Additionally, the Board must, on or before December 31 of each year, furnish the City Controller an estimate of all proposed expenditures for the next calendar year. The books, accounts, records and transactions of the Board are subject to examination, audit, and supervision by the Indiana State Board of Accounts. Of particular relevance to this proceeding, the rates and charges of the municipally-owned utilities managed by the Board are subject to approval of the Commission as well as the Board. Finally and most importantly, the Board has a fiduciary duty to the beneficiaries of the public charitable trust, the inhabitants of the City of Indianapolis.

Q. WHEN WAS THE STEAM SYSTEM ACQUIRED?

A. In November 2000, the Board acquired from Indianapolis Power & Light Company ("IP&L") the Perry K steam production plant, the steam distribution plant and other assets used to produce and deliver steam to customers throughout the City of Indianapolis. The acquisition of those assets was approved by the Commission in an order issued on October 4, 2000 in Cause No. 41716. The transaction was consummated in November 2000, and the assets purchased became part of the public charitable trust that the Board is entrusted to manage. Since that time, the Board, pursuant to its statutory authority under Indiana Code Section 8-1-11.1-3, has operated the steam business as a municipally-owned steam utility under the trade name Citizens Thermal Energy.

Q. DOES OPERATION OF THE STEAM SYSTEM AS A MUNICIPALLY-OWNED STEAM UTILITY AND PART OF THE PUBLIC CHARITABLE TRUST PROVIDE BENEFITS TO THE STEAM SYSTEM'S CUSTOMERS?

A. Absolutely. Our customers enjoy significant cost savings as a result of the Steam System being a municipally-owned utility not subject to Federal income tax and with access to tax exempt debt. Moreover, I believe the unique nature of our organization offers much value to the Steam System's customers. Our relationship with our municipal utility customers is defined by the purposes for which the public charitable trust was created. There are no shareholders who profit from the success of the Steam System. Rather, the Board is entrusted with a fiduciary duty to the inhabitants of the City of Indianapolis, and one of its principal missions is to reliably and safely meet the demands of our municipal utility customers at the lowest rates reasonably practical.

Indeed, I believe the Board's interests are aligned with those of the Commission and the Indiana Office of Utility Consumer Counselor (the "OUCC"). While we may disagree from time to time with positions taken by the OUCC, we respect the agency's role as an advocate for ratepayers and its stated mission to "represent all Indiana consumers to ensure quality, reliable utility services at the most reasonable prices possible." Likewise, I believe the Commission's mission statement, "to assure that utilities and others use adequate

planning and resources for the provision of safe and reliable utility services at reasonable cost," is strikingly similar to our own.

Q. EARLIER YOU MENTIONED THAT THE BOARD MANAGES AND CONTROLS A NUMBER OF BUSINESSES. WHAT OTHER BUSINESSES BESIDES THE TWO MUNICIPALLY-OWNED UTILITIES DOES THE BOARD MANAGE AND CONTROL?

A. The assets of the public charitable trust also include a district cooling system serving downtown Indianapolis, a coke manufacturing plant located in Indianapolis, certain oil interests in Greene County, Indiana and the stock of Citizens By-Products Coal Company ("By-Products"), a West Virginia Corporation that has been in existence for many years. Through By-Products, the Board engages and invests in a variety of energy-related businesses.

The Board is currently in the process of finalizing plans for the disposition of the coke manufacturing plant. It is certain that on or before September 30, 2007 (the cutoff in this proceeding for test-year adjustments to reflect changes that are fixed, known and measurable), the Board will no longer operate the coke manufacturing plant.

Q. WHY DID THE BOARD DECIDE TO PURSUE A DISPOSITION OF THE COKE MANUFACTURING PLANT?

A. There are a number of factors relating to the continuing viability of the coke manufacturing business that led the Board to conclude a disposition of the plant should be pursued. The coke manufacturing business is very capital intensive. It

also is very volatile with dramatic swings in demand for and pricing of coke products. As a result, returns on invested capital are uncertain. Our coke manufacturing business has been plagued by problems in recent years, including the bankruptcy of several customers, foreign competition, coal shortages, high coal prices, environmental problems and more.

Q. WILL THE DISPOSITION OF THE COKE MANUFACTURING PLANT AFFECT THE STEAM SYSTEM?

A. Yes. As Mr. Brehm discusses in his prepared testimony, the disposition of the coke manufacturing plant will affect the amount of Corporate Support Services or "CSS" costs that are allocated to the Steam System.

RATE RELIEF REQUESTED

Q. WHEN WERE THE STEAM SYSTEM'S PRESENT RATES AND CHARGES PLACED IN EFFECT?

A. On November 20, 2000, Citizens Thermal Energy placed into effect its Steam Service Tariff, Rates, Terms and Conditions for Steam Service Within Marion County, Indiana, as authorized by the Commission in its October 2000 Order in Cause No. 41716 approving Citizens Thermal Energy's acquisition of the steam utility assets from IP&L. However, the rates and charges Citizens Thermal Energy placed into effect in November 2000 were unchanged from the rates and charges IP&L had in effect at the time of the acquisition, which were established in a Commission Order issued in January 1993 in Cause No. 39440. Thus, if the

proposed rates and charges are approved by the Commission, it will be the first base rate increase for the Steam System's customers in over 14 years.

Q. WHY IS CITIZENS THERMAL ENERGY REQUESTING AN INCREASE TO ITS BASE RATES AND CHARGES FOR STEAM UTILITY SERVICE?

A. As discussed above, given the nature of our organization, we are never pleased to request a rate increase. As explained by the other witnesses testifying on behalf of Petitioner, however, the Steam System's current rates and charges simply are not producing income sufficient for it to maintain its utility property in a sound physical and financial condition to render adequate and efficient service. In the 14 years since the base rates and charges presently in effect were established, the costs of operating and maintaining the steam business have risen. Operations and maintenance expenses have increased, reflecting general inflationary pressures. As discussed in more detail in the prepared testimony of Messrs. Tracy and Dillard, the Steam System faces significant challenges in the coming years, including the replacement of aging production and distribution plant. Moreover, the Steam System needs to increase its revenues in order to ensure it maintains the credit ratings needed to obtain low cost financing that may be necessary to fund future plant investments.

Q. WHAT IS CITIZENS THERMAL ENERGY'S CURRENT CREDIT RATING?

A. On December 5, 2006, Standard & Poor's affirmed its A- rating of Citizens Thermal Energy, with a stable outlook. However, Standard & Poor's noted in its report the Steam System's need for a base rate increase. A copy of the Standard & Poor's report is attached as Petitioner's Exhibit CBL-2.

Q. HOW DO CITIZENS THERMAL ENERGY'S PROPOSED RATES AND CHARGES FOR STEAM UTILITY SERVICE COMPARE TO THE RATES AND CHARGES OF OTHER STEAM UTILITIES?

A. Based on the results of an annual study conducted in 2006, the Steam System's existing rates are among the lowest of steam utilities located in the Midwest. Even if the rates and charges of the other steam utilities that participated in that study do not increase, the rates and charges for steam utility service Citizens Thermal Energy has proposed in this proceeding will continue to be lower than average for the group.

Q. HAS THE BOARD APPROVED THE RATE RELIEF THAT CITIZENS THERMAL ENERGY IS REQUESTING THE COMMISSION APPROVE IN THIS PROCEEDING?

A. Yes. On December 13, 2006, the Board adopted a Resolution authorizing and directing that a petition be filed with the Commission prior to January 1, 2007 requesting (i) an increase in the operating revenues produced by the Steam System's rates and charges, (ii) approval of revisions to its depreciation accrual rates for its steam utility plant and (iii) authority to change the frequency of its fuel cost adjustment filings from an annual to a quarterly basis. As a result,

Citizens Thermal Energy filed its Verified Petition in this Cause on December 29, 2006. A certified copy of that Board Resolution is attached to my testimony as Petitioner's Exhibit CBL-3. A certified copy of the Board Resolution approving the proposed rates and charges and terms and conditions of service is attached hereto as Petitioner's Exhibit CBL-4.

Q. PLEASE IDENTIFY PETITIONER'S EXHIBIT CBL-5.

A. Petitioner's Exhibit CBL-5 consists of the legal notices published in connection with the rate relief requested in this proceeding.

CONCLUSION

Q. PLEASE INTRODUCE THE OTHER WITNESSES TESTIFYING ON BEHALF OF CITIZENS THERMAL ENERGY IN THIS PROCEEDING AND PROVIDE A BRIEF OVERVIEW OF THEIR TESTIMONY.

A. The following witnesses are offering testimony in support of the relief requested by Citizens Thermal Energy in this proceeding:

- Mr. William A. Tracy, Senior Vice President of Operations, will describe the operations of the Steam System, including initiatives to control costs and improve efficiency and customer service.
- Mr. John R. Brehm, Senior Vice President and Chief Financial Officer, sponsors the Steam System's test year income statement and balance sheet and also describes certain *pro forma* adjustments to the balance sheet and test year allocation of Corporate Support Services costs to the Steam System.

- Mr. James O. Dillard, General Manager, Facilities and Engineering, supports the Steam System's revenue requirement for extensions and replacements. Mr. Dillard also will describe the Steam System's investment in its production plant to comply with environmental regulations regulating air emissions applicable to the plant, as well as certain other projects the utility has undertaken.
- Mr. Michael D. Strohl, Corporate Treasurer, addresses the Steam System's debt service requirements.
- Mr. Donald J. Clayton, a consultant with Tangibl, LLC sponsors a depreciation study performed for Citizens Thermal Energy and the resulting proposed depreciation rates
- Ms. LaTona S. Prentice, Executive Director of Rates and Regulatory Affairs, describes the Steam System's overall phase one revenue requirement and also addresses the phase two inclusion in base rates of certain costs that will be incurred under the Covanta steam purchase agreement that will take effect in December 2008.
- Mr. Kerry A. Heid of Heid Rate and Regulatory Services explains and sponsors the Steam System's cost of service study, rate design, proposed rates, and tariffs.
- Mr. Craig A. Jones, Manager - Rates and Regulatory Affairs, describes Citizens Thermal Energy's proposal to change the frequency of its Steam System fuel cost adjustment filings from an annual to a quarterly basis as well

as proposed changes to the terms and conditions of Citizens Thermal Energy's steam utility service tariff.

Q. DOES THAT CONCLUDE YOUR PREPARED DIRECT TESTIMONY?

A. Yes, it does.

VERIFICATION

STATE OF INDIANA)
) ss:
COUNTY OF MARION)

The undersigned, Carey B. Lykins, under penalties of perjury and being first duly sworn on his oath, says that he is the President and Chief Executive Officer of Citizens Thermal Energy; that he caused to be prepared and read the foregoing Direct Testimony; and that the representations set forth therein are true and correct to the best of his knowledge, information and belief.

Carey B Lykins

By: Carey B. Lykins
President and Chief Executive Officer
Citizens Thermal Energy

Subscribed and sworn to before me, a Notary Public, this 29th day of March, 2007.

Kim M. Potochnik
Signature

Kim M. Potochnik
Printed Name

My Commission Expires: 9-28-2009

My County of Residence: MARION County
State of Indiana

COPY

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VERIFIED PETITION

The Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as successor trustee of a public charitable trust, d/b/a Citizens Thermal Energy ("Petitioner"), respectfully petitions the Indiana Utility Regulatory Commission ("Commission") for: (i) authority to increase its rates and charges for steam utility service; (ii) approval of a new schedule of rates and charges applicable thereto; (iii) approval of certain changes to its general terms and conditions for steam service; (iv) approval of new depreciation accrual rates; and (v) approval to file a quarterly fuel cost adjustment ("FAC") application in lieu of an annual FAC application. In support of its Verified Petition, Petitioner respectfully shows the Commission:

Nature of Petitioner and Regulatory Status

1. Petitioner is the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as successor trustee of a public charitable trust, d/b/a Citizens Thermal Energy. Its principal office is at 2020 North Meridian Street, Indianapolis, Indiana 46202. As of September 30, 2006, Petitioner provided steam service to 259 customers in the City of Indianapolis, Indiana through steam production and distribution facilities purchased in November 2000 from Indianapolis Power & Light Company ("IPL"). The Commission approved Petitioner's purchase of those facilities from IPL by Order entered October 4, 2000 in Cause No. 41716.

2. Petitioner provides adequate and efficient steam service to the public in the downtown and near downtown area in the City of Indianapolis, Indiana by means of steam utility plant, properties, equipment and facilities owned, operated, managed and controlled by it, which are used and useful for the convenience of the public. Pursuant to the terms of Indiana Code § 8-1-11.1-3(a), Petitioner is charged by law with the duty of, and has all the necessary power and authority to furnish and sell services and products of, and to make all necessary construction, reconstruction, repairs, renewals, enlargements, extensions or additions to its plant and property, which in its judgment, are "desirable or necessary for the proper conduct of such business and the proper serving of the inhabitants of the city and adjacent, contiguous or suburban communities or territory" within Marion County, Indiana.

4. Petitioner is a municipal steam utility subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana, including certain provisions of the Public Service Commission Act, as amended.

5. Petitioner's rates and charges, and its terms and conditions for steam service, are subject to the approval of this Commission by virtue of the provisions of Indiana Code § 8-1-

11.1-3(c)(9). Pursuant to Indiana Code § 8-1-11.1-3.1, Petitioner has all rights and powers conferred upon a municipally owned utility and operates as both the board and the municipal legislative body for purposes of Indiana Code § 8-1.5-3-8.

6. Under the provisions of Indiana Code § 8-1.5-3-8, Petitioner is required by law to "furnish reasonably adequate services and facilities." Petitioner's steam utility system is properly maintained and is in satisfactory physical condition to render reasonably adequate service to its customers.

7. Pursuant to Indiana Code § 8-1.5-3-8, rates and charges made by Petitioner for any service rendered or to be rendered, either directly or in connection therewith, "must be nondiscriminatory, reasonable, and just." Petitioner is obligated by law to maintain rates and charges for any service rendered by it to "produce an income sufficient to maintain the utility property in a sound physical and financial condition to render adequate and efficient service." Indiana Code § 8-1.5-3-8(d). Petitioner needs to increase its revenues and income from the furnishing of steam utility service so that it can continue to operate and maintain its steam utility system in satisfactory physical condition to render reasonably adequate service to its customers and to meet the requirements for reasonable and just rates and charges for services under Indiana Code § 8-1.5-3-8(c) and (d).

Petitioner's Present Rates and Charges

8. On November 20, 2000, Petitioner placed into effect a Steam Service Tariff, Rates, Terms and Conditions for Steam Service Within Marion County, Indiana, as authorized by the Commission in its October 4, 2000 Order in Cause No. 41716. In the foregoing Order, the Commission found that "the Board should adopt IPL's current rates and charges, as well as its terms and conditions for service." Order at p.7. IPL's rates and charges, and terms and

conditions, for steam service were previously established in a 1992 steam rate case. See Commission Order in Cause No. 39440, entered January 13, 1993.

9. Petitioner's schedule of rates and charges for steam utility service also includes Standard Contract Rider No. 1, Fuel Cost Adjustment (Applicable to Rate 1 and Rate 2). The FAC set forth in Standard Contract Rider No. 1 is revised once each year effective June 1st. As a result of a Settlement Agreement, which the Commission approved in Cause No. 41969FC3S1, Petitioner's revisions to its FAC are subject to an "earnings test." See Order entered June 23, 2004 in Cause No. 41969FC3S1. The Commission approved $7,850,000 as the amount of Petitioner's "authorized earnings," or net operating income, for purposes of determining the fuel cost adjustment factor in FAC 5 and thereafter until Petitioner's next general rate case. The amount of Petitioner's "authorized earnings" for purposes of its FAC filings will be reset to the level of net operating income authorized by final Order in this general rate proceeding.

10. Petitioner's operation and maintenance expenses and investments in plant and extensions and replacements have increased since April 30, 1992, the close of the test year in Cause No. 39440. Accordingly, Petitioner's rates and charges for steam utility service, as approved by the Commission in Cause No. 41716, and as thereafter modified by annual fuel cost adjustments, result in the collection of revenues which do not meet the requirements of reasonable and just rates and charges set forth in Indiana Code § 8-1.5-3-8. Therefore, Petitioner's rates and charges are and will be too low and insufficient to:

> (1) Pay all the legal and other necessary expenses incident to the operation of the utility, including:
>
> (A) Maintenance costs;
> (B) Operating charges;
> (C) Upkeep;
> (D) Repairs;
> (E) Depreciation; and

(F) Interest charges on bonds or other obligations, including leases;

(2) Provide a sinking fund for the liquidation of bonds or other obligations, including leases;

(3) Provide a debt service reserve for bonds or other obligations, including leases, in an amount established by the [Board of Directors], not to exceed the maximum annual debt service on the bonds or obligations or the maximum annual lease rentals;

(4) Provide adequate money for working capital;

(5) Provide adequate money for making extensions and replacements to the extent not provided for through depreciation in subdivision (1); and

(6) Provide money for the payment of any taxes that may be assessed against the utility.

Therefore, Petitioner's rates and charges presently in effect are unlawful under Indiana Code § 8-1.5-3-8.

Petitioner's Proposed Rates

11. Petitioner proposes, subject to the authorization and approval of this Commission, to cancel its existing schedule of rates and charges for steam utility service and to file with the Commission, in lieu thereof, a new schedule of rates and charges which will provide it with reasonable and just charges for services within the meaning of Indiana Code § 8-1.5-3-8.

12. Petitioner's proposed revised schedule of rates and charges for steam utility service will be accompanied by the prepared direct testimony and exhibits of Petitioner's witnesses and will be filed with the Commission prior to the commencement of public hearings on Petitioner's case-in-chief.

13. In accordance with 170 IAC 1-1.1-9(b), Petitioner proposes and requests that the 12-month period ended September 30, 2006 be the test year fixed by the Commission, and that the cut-off date for adjustments that are reasonably known, fixed, and measurable, be within

twelve months following the close of the test year, and that the cut-off date for valuing Petitioner's plant in service be September 30, 2007. The September 30, 2007 cut-off date will allow improvements, which must be made in order to comply with federal MACT regulations to be considered in the valuation Petitioner's plant in service. Petitioner is unable at this time to determine the exact revenue requirements of its steam service operations as of the 12-months ended September 30, 2006 and, therefore, is unable to determine the exact amount of the increase in its base rates and charges for steam utility service which will be required, but Petitioner requests that the Commission approve revised rates and charges for Petitioner's use which will produce an income sufficient to meet the requirements of Indiana Code § 8-1.5-3-8.

New Depreciation Accrual Rates

14. Petitioner has prepared and will present a depreciation study as part of its case-in-chief. Petitioner requests Commission approval of revisions to its depreciation accrual rates for its steam utility plant in accordance with the results of that study.

Quarterly Fuel Cost Adjustment Filings

15. Petitioner proposes a change to the frequency of its fuel cost adjustment filings from an annual to a quarterly basis. The parties to the Settlement Agreement in IPL's Cause No. 39440, which was approved by the Commission on January 13, 1993, agreed that IPL would change its fuel cost adjustment on an annual basis, rather than the customary quarterly basis. That agreement was made at a time when the steam fuel mix and fuel prices were more predictable, and as a result IPL's fuel costs were relatively stable. At that time, changes to IPL's steam fuel cost adjustment on a quarterly basis were minimal, and the parties agreed that an annual fuel cost adjustment change would be appropriate. In more recent years, fuel prices have become more volatile and the steam fuel mix is subject to considerable change during the course

of a year, resulting in significant fuel cost variances by year's end that must be recovered or refunded during the subsequent 12-month period.

16. Changing the frequency of Petitioner's fuel cost adjustments from annually to quarterly will provide a more market-responsive fuel cost rate, thus sending more appropriate price signals to customers. Market responsive rates will send an appropriate price signal to customers in real time so customers can react accordingly.

17. A shorter reconciliation period (i.e., quarterly rather than annually) also will allow Petitioner to address any causes of variances more efficiently.

18. Quarterly changes to Petitioner's fuel cost adjustment also will keep fuel cost variances at a minimum level. When levels of fuel cost variances are reduced it helps keep working capital needs and expenses of Petitioner at a more reasonable level during periods of under recovery, and prevents customers from paying too much during periods of over recovery.

Procedural Matters

19. Petitioner will publish notice to its customers of the filing of this Verified Petition and the requested upward adjustment to its rates and charges.

20. Petitioner proposes that its new rates and charges be based upon its steam utility operations at September 30, 2006 and the results of its operations on an as-adjusted basis for the 12-month period after that date, and that the cut-off date for valuing Petitioner's plant in service be September 30, 2007. Pursuant to 170 IAC 1-1.1-15(b) of the Commission's Rules of Practice and Procedure, Petitioner requests that the Commission promptly convene a prehearing conference and preliminary hearing for the purposes of fixing a procedural schedule in this proceeding and resolving such other matters as may properly come before the Commission.

21. The names and addresses of Petitioner's attorneys in this matter, to whom all correspondence and communications in this Cause should be sent, are:

Michael E. Allen
Attorney No. 20768-49
Citizens Thermal Energy
2020 N. Meridian Street
Indianapolis, IN 46202
Telephone: (317) 927-4318
Facsimile: (317) 927-4318
E-mail: mallen@cgcu.com

Michael B. Cracraft
Attorney No. 3416-49
Hackman Hulett & Cracraft, LLP
111 Monument Circle, Suite 3500
Indianapolis, IN 46204-2030
Telephone: (317) 636-5401
Facsimile: (317) 686-3288
E-mail: mcracraft@hhclaw.com

Said attorneys are duly authorized to accept service of papers in this Cause on behalf of Petitioner. In addition, papers filed in this proceeding should be served on:

LaTona S. Prentice
Executive Director of Regulatory Affairs
Citizens Thermal Energy
2020 N. Meridian Street
Indianapolis, Indiana 46202
E-mail: lprentice@cgcu.com

WHEREFORE, Petitioner Citizens Thermal Energy respectfully requests that the Indiana Utility Regulatory Commission make an investigation and hold such hearings as it shall deem necessary and advisable in this proceeding; and thereafter, make and enter an Order in this Cause:

(i) Finding that Petitioner's existing rates and charges for steam utility service are unjust, unreasonable, unlawful and inadequate to provide its annual requirements for funds to pay for those items enumerated in Indiana Code § 8-1.5-3-8;

(ii) Determining, and by Order authorizing and approving just, reasonable, and sufficient rates and charges to be imposed by Petitioner in the future, in lieu of such present rates and charges found to be unjust and unreasonable;

(iii) Authorizing Petitioner to revise the depreciation accrual rates applicable to its steam utility property in accordance with the depreciation study to be submitted in Petitioner's evidence herein;

(iv) Approving the filing of quarterly applications for fuel cost adjustments;

(v) Authorizing and approving the filing of new schedules of rates and charges and terms and conditions of service applicable to the steam service rendered by Petitioner, embodying the just, reasonable and sufficient rates and charges;

(vi) Authorizing and approving additional requested changes to Petitioner's tariffs; and

(vii) Granting such other and further relief as the Commission may deem necessary and appropriate.

DATED this 28th day of December, 2006

BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS SUCCESSOR TRUSTEE OF A PUBLIC CHARITABLE TRUST, D/B/A CITIZENS THERMAL ENERGY

By: _____

Sr. Vice President, Operations

STATE OF INDIANA)
) SS:
COUNTY OF MARION)

William A. Tracy, being first duly sworn upon oath, deposes and says that he is the Sr. Vice President, Operations for the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, as successor trustee of a public charitable trust, d/b/a Citizens Thermal Energy, Petitioner in the above-entitled Cause; that as such officer he executed the foregoing Petition for and on behalf and in the name of said Board of Directors for Utilities, and has authority to do so; that he has read the foregoing Petition and is familiar with the contents thereof; and that the statements therein contained are true to the best of his knowledge, information and belief.

William A. Tracy, Sr. Vice President, Operations

STATE OF INDIANA)
) SS:
COUNTY OF MARION)

Before me, a Notary Public in and for said County and State, personally appeared William A. Tracy who acknowledged the execution of the foregoing Petition.

Witness my hand and notarial seal this 28th day of December, 2006.

My Commission Expires:

8/11/08

NOTARY PUBLIC SEAL INDIANA

Notary Public
Printed: ANN DUNAVENT
Resident of HANCOCK County

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Verified Petition of the Board of Directors for Utilities was served on the Indiana Office of the Utility Consumer Counselor by delivering a copy thereof to Indiana Government Center North, 100 North Senate Avenue, Room N501, Indianapolis, Indiana 46204-2208 on the 29th day of December, 2006.

An Attorney for Petitioner
Citizens Thermal Energy

Michael B. Cracraft (#3416-49)
Hackman Hulett & Cracraft, LLP
111 Monument Circle, Suite 3500
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(317) 636-5401

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Indianapolis, IN 46202
(317) 927-4318

Attorneys for Petitioner
Citizens Thermal Energy

STANDARD &POOR'S

PUBLIC FINANCE

Citizens Thermal Energy, Indiana

Primary Credit Analysts:
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Secondary Credit Analysts:
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standardandpoors.com

Credit Profile

AFFIRMED

Indianapolis, Indiana

$110.915 mil. Indianapolis (Citizens Thermal Energy)	AAA/A-(SPUR)
OUTLOOK:	STABLE

Rationale

Standard & Poor's Ratings Services affirmed its 'A-' underlying rating (SPUR) on Citizens Thermal Energy, Ind.'s series 2001A revenue bonds. The bonds carry a 'AAA' long-term rating, which reflects credit enhancement due to bond insurance.

The rating on Citizens Thermal Energy System's bonds is supported by the system's long-term contracts as well as its small but stable customer base, competitive rates, stable operations, adequate regulatory support for the steam business, and strong growth in demand for the chilled water business.

Credit strengths include:

- The strong business position of the regulated steam division, which benefits from a purchased gas adjustment mechanism and represents about 40% of cash available to meet debt service;
- Long-term contracts with leading customers Indiana University-Purdue University at Indianapolis (IUPUI; through 2020) for chilled water and steam, and pharmaceuticals manufacturer Eli Lilly (through 2016) for chilled water service;
- Low counterparty risk due to the strong investment-grade characteristics of its customers, led by exceptionally strong top customers Eli Lilly (AA/Stable/A-1+) and IUPUI ('AA/Stable');
- Strong debt service coverage, as reflected by 1.90x coverage on senior lien debt and 1.75x coverage on combined debt in fiscal 2005 and strong internal funding of capital requirements, with no plans for further debt financing; and
- Strong liquidity, with $44.3 million in unrestricted cash and investments, equal to about 303 days' cash on hand.

RatingsDirect
Publication Date
Dec. 5, 2006

Credit concerns include:

- The need for rate relief over the next 12 months for its regulated steam division, for which Citizens projects it will earn less than $700,000, down significantly from the more than $3 million in the prior two years;
- Very high customer concentration, with top offtakers Eli Lilly and IUPUI representing 30% and 21%, respectively, of system revenues in 2005;
- Dependence of projected debt service coverage on forecasted margins from unregulated chilled water expansion, which could experience slippage of financial measures if demand weakens, costs increase significantly or alternative chilling technologies become more competitive;
- Elevated capital requirements due to Citizens' plans to expand its chilled water system to accommodate demand growth, although Citizens expects to internally fund its capital projects;
- Adequate fuel supply, most of which is locked in under long-term contracts, although costs could climb due to increasing natural and coke oven gas prices; and
- High, but declining debt leverage of 76% as of Sept. 30, 2005;

The bonds are secured solely by the revenues of the thermal energy system (Citizens Thermal Energy), including all revenues of the steam and chilled water divisions. Citizens Thermal Energy is a subsidiary of Citizens Gas & Coke Utility ('A+/Stable'), and is not bankruptcy remote from its parent. Citizens is unique among municipal utilities in that it is organized as a public charitable trust. Although the Department of Public Utilities, an executive department of the City of Indianapolis ('AAA/Stable'), serves as the trustee, Citizens is governed by an independent board of directors that ensures the trust is operated solely for the benefit of Marion County residents.

Citizens Thermal Energy provides steam and chilled water to residential, business, and governmental customers in downtown Indianapolis. System assets consist of one steam plant and distribution system and two distinct chilled water plants, each with its own distribution system. Citizens Thermal Energy purchased the steam and chilled water systems from Indianapolis Power & Light Co. (IPL) in 2000 and has since operated them as separate divisions under the Citizens Thermal Energy business line. In 2005, the steam and chilled water divisions accounted for about 40% and 60% of operating cash flow respectively.

As of Sept. 30, 2005, Citizens Thermal Energy had $164 million in outstanding debt.

The business profile of the consolidated Citizens Thermal Energy system is satisfactory (a '5' on Standard & Poor's 10-point scale where '1' is excellent), and reflects the regulatory protection and fuel cost passthrough capability of the steam business, high geographic concentration in a downtown Indianapolis, the strong demand for chilled water service, a highly concentrated but generally highly rated customer base, and adequately supportive contracts with the system's largest customers.

The Indiana Utilities Regulatory Commission (IURC) regulates the steam division. The utility is permitted to recover excess fuel costs of the steam division through its fuel cost adjustment (FCA). Citizens Thermal Energy has not filed for, nor has the IURC granted, a base rate increase for the system since Citizens Thermal Energy acquired it in 2000.

The utility expects to address the steam division's declining cash flow through a rate case filing to be submitted over the next several months. The division, whose strong business profile provides important support to the rating, is showing weak earnings and cash flow in fiscal 2006, and will likely deliver weak results again in fiscal 2007 before rate relief can be granted in time for the following year.

The unregulated chilled water division, in contrast, has demonstrated strong revenue growth and profitability, which has helped to offset the deteriorating financial performance of the regulated steam division. Growth in revenues averaged 15% annually in 2004 and 2005, exceeding the 9% average annual growth in

commodity delivered. Cash flow has also increased and accounted for roughly two-thirds of operating cash flow in 2005.

Capital requirements remain elevated at about $57 million in planned capital spending from 2006 through 2010, as Citizens continues to expand its chilled water system to meet strong market demand. Citizens recently completed the expansion of its West Street system at a cost of about $9 million. Importantly, Citizens has scaled back its thermal system capital program by about 33% for the four-year period from 2005-2008. The system has around $3 million to $4 million in maintenance capital requirements annually.

Citizens' financial policy is considered moderate. While the utility still targets robust levels of debt service coverage well above its 1x rate covenant, its debt leverage remains high, even for its nonregulated and somewhat riskier chilled water business. The utility has backed away for future debt financing and instead plans on internally funding capital expenditures for the foreseeable future.

Debt service coverage was adequate in fiscal 2005, at 1.9x on senior lien debt (rated) and 1.75x on combined senior and junior lien debt. Citizens projects that its thermal energy system will achieve senior lien debt service coverage of between 1.6x and 2.2x, which is lower than previous forecasts, but still adequate for the rating. The thermal energy system should easily exceed 1.3x coverage on its senior lien debt and 1.1x on its combined debt, even after factoring in a more conservative forecast of interest rates and no chilled water system growth.

Debt leverage remains high at 76%, but is declining due to the system's ability to fully fund capital expenditures with net operating cash flows. Floating rate debt accounted for an aggressive 31% of outstanding debt, but net floating rate debt was a very modest 3% after accounting for the thermal energy system's sizable cash reserves at Sept. 30, 2005.

Liquidity

Liquidity is adequate and consisted of about $44.3 million in unrestricted cash and short-term investments as of Sept. 30, 2006—equivalent to more than 300 days' cash. Short-term investments include a debt service reserve funded to maximum annual debt service, currently about $13 million. Liquidity is enhanced by the ability of the system to borrow funds internally from parent company Citizens Gas & Coke through intercompany notes, although Citizens Gas does not guarantee availability of funds or Citizens Thermal Energy obligations. Debt maturities are moderate ranging from $4.6 million to $5.1 million through 2008. Capital requirements are more substantial, averaging $15 million through 2008.

Outlook

The stable outlook is based on strong projected cash flows from the chilled water division and adequate debt service coverage overall. The outlook assumes Citizens will file a general rate case for the steam division and receive from the IURC adequate and timely rate relief. The outlook also assumes conservative management of the system's fuel price exposure as well as continued deliveries of coke oven gas by Citizen's manufacturing division or similarly priced replacement gas. Delays in obtaining adequate rate relief for the steam system, significant escalation in fuel costs for the chilled water division, or additional debt issuance could place pressure on the rating.

Citizen's Gas & Coke

Thermal Energy System (Steam & Chilled Water Divisions)

	Year End Sept. 30,				
	2005	2004	2003	2002	2001

Citizen's Gas & Coke (cont.'d)

Financial Results ($000s)					
Revenues	72,844	66,071	61,834	56,701	48,998
Income growth (%)	10	7	9	16	N.A.
Operating income	17,037	17,306	16,164	18,797	13,356
Net available for debt service	19,441	19,279	18,557	19,850	17,573
Total debt service	11,128	11,213	10,718	6,042	4,297
Debt Service Coverage					
Series 2001A (x)	1.90	1.88	1.91	3.29	4.09
Combined (x)	1.75	1.72	1.73	N.A.	N.A.

STATE OF INDIANA)
) SS:
COUNTY OF MARION)

In Re: An excerpt from the Regular Meeting held December 13, 2006

VERIFIED CERTIFICATE OF RESOLUTION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS d/b/a CITIZENS GAS & COKE UTILITY

The undersigned officer hereby certifies the following excerpt from the minutes of the regular meeting of the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis d/b/a Citizens Gas & Coke Utility held December 13, 2006, to-wit:

On June 23, 2004, the Indiana Utility Regulatory Commission ("Commission") approved a Settlement Agreement in Cause No. 41969FAC03S1, which obligates Citizens Thermal Energy (the "Utility") to file a petition for approval of a new schedule of rates and charges and terms and conditions for steam service prior to January 1, 2007. The Utility placed into effect its existing Steam Service Tariff, Rates, Terms and Conditions for Steam Service Within Marion County, Indiana (the "Rates and Terms") on November 20, 2000, as authorized by the Commission in its October 4, 2000 Order in Cause No. 41716. The Rates and Terms were based upon, and are identical to, the steam rates and charges and terms and conditions of steam service previously approved for Indianapolis Power & Light Company in its 1992 steam rate case (Cause No. 39440, Order approved January 13, 1993).

Mr. Lykins and Ms. Prentice discussed with the Board the results of a study Utility management has undertaken of the Utility's revenue requirements for the proposed test year ending September 30, 2006, considering pro forma adjustments for items which will be fixed, known and measurable and will occur during the twelve months following the end of the test year. The Utility's rates and charges for steam utility service, as approved by the Commission

in Cause No. 41716, as thereafter modified by an annual fuel adjustment charge ("FAC"), result in the collection of revenues for the provision of steam service which do not meet the requirements for "reasonable and just rates and charges for service," as set forth in Indiana Code § 8-1.5-3-8(c). Mr. Lykins and Mrs. Prentice further indicated there was a need for the Utility to seek approval from the Commission to increase the Utility's rates and charges for steam service to meet the statutory standard for "reasonable and just rates and charges for services" and for approval of a new schedule of rates and charges for steam service. Based on a preliminary analysis of the pro forma revenue requirements for the test year ending September 30, 2006, Mr. Lykins indicated that the Utility needs an approximate increase in annual steam operating revenues of 9% to 11.5%, depending on the final results of pro forma adjustments to test year numbers.

Mr. Lykins recommended that the Board authorize management to prepare and file a Petition with the Commission seeking an increase in rates and charges for steam service, approval of a new schedule of rates and charges for steam service and approval of certain changes to the Utility's terms and conditions of steam service, including authority to file for quarterly changes in the cost of fuel in lieu of the annual FAC. After discussion, the following Resolution was unanimously adopted:

> **RESOLVED by the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis, that:**
>
> **(1) The officers of the Utility are hereby authorized and directed, individually or jointly, to execute a Petition on behalf of the Board requesting an increase in the operating revenues produced by the Utility's rates and charges for steam service and approval of the other relief discussed at the Board meeting, and cause such Petition to be filed in a timely manner with the Commission prior to January 1, 2007;**

(2) Management of the Utility is hereby authorized and directed to provide such public notice of the filing of the Petition as may be required by law or otherwise determined by them to be necessary or advisable;

(3) Management of the Utility also shall prepare such testimony and exhibits as necessary to support the relief requested in the Petition and take such other actions as they may determine to be advisable in order to successfully prosecute any proceedings on the Petition; and

(4) The proposed new schedule of rates and charges for steam service, terms and conditions of service and other materials comprising the requested relief in the general rate case shall be provided to the Board prior to filing with the Commission and will be subject to the review and approval of the Board as required by I.C. 8-1-11.1-3.1, I.C. 8-1-11.1-3(c)(9) and I.C. 8-1.5-3-8.

The undersigned officer of the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis d/b/a Citizens Gas & Coke Utility, a municipal corporation of the State of Indiana duly authorized to do business pursuant to Indiana Code 8-1-11.1, hereby certifies that the foregoing is a full, true and correct copy of the resolution adopted by the Board of Directors for Utilities at its regular meeting held December 13, 2006, as the same appears in the record of minutes of the Board in the custody of the undersigned as such officer.

IN WITNESS WHEREOF, I have hereunto set my hand this 13th day of December 2006.

John R. Whitaker
Assistant Secretary

ACKNOWLEDGMENT

Before me appeared John R. Whitaker, to me personally known, who being by me duly sworn did affirm that he is the Assistant Secretary of the Board of Directors for Utilities of the Department of Public Utilities of the City of Indianapolis d/b/a Citizens Gas & Coke Utility, a municipal corporation of the State of Indiana that has no corporate seal and that this certificate was made and executed by him for and on behalf of said Board by the authority vested in said Board pursuant to Indiana Code 8-1-11.1 as its free and voluntary act and deed.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal in Indianapolis, Indiana, this 13th day of December 2006.

Monica E. Kapp

Monica E. Kapp, Notary Public and
Resident of Marion County, State of Indiana

My Commission Expires:
December 17, 2007

Petitioner's Exhibit CBL-4 will be late filed
with the Commission as soon as possible and prior to the
scheduled evidentiary hearing.

Title

522-4678346

PUBLISHER'S AFFIDAVIT

State of Indiana SS:
MARION County

Personally appeared before me, a notary public in and for said county and state, the undersigned **Stacey McCullough** who, being duly sworn, says that SHE is clerk of the INDIANAPOLIS NEWSPAPERS a DAILY STAR newspaper of general circulation printed and published in the English language in the city of INDIANAPOLIS in state and county aforesaid, and that the printed matter attached hereto is a true copy, which was duly published in said paper for **1** time(s), between the dates of:

01/24/2007 and **01/24/2007**

Stacey McCullough Clerk
Title

Subscribed and sworn to before me on **01/24/2007**

Susan Ketchem
Notary Public

My commission expires:_____

"OFFICIAL SEAL"
Susan Ketchem
Notary Public, State of Indiana
My Commission Exp. 05/06/2011

PUBLIC NOTICE
EFORE THE INDIANA UTILITY EGULATORY COMMISSION CAUSE NO. 43201 PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF HE DEPARTMENT OF PUBLIC TILITIES OF THE CITY OF IN-IANAPOLIS, AS SUCCESSOR RUSTEE OF A PUBLIC CHARI-ABLE TRUST D/B/A CITIZENS THERMAL ENERGY FOR (1) AU-THORITY TO INCREASE ITS RATES AND CHARGES FOR TEAM UTILITY SERVICE, (2) PPROVAL OF A NEW SCHED-ULE OF RATES AND CHARGES PPLICABLE THERETO, (3) AP-ROVAL OF CHANGES TO ITS GENERAL TERMS AND CONDI-TIONS FOR STEAM SERVICE, (4) APPROVAL OF NEW DEPRE-CIATION ACCRUAL RATES, AND (5) APPROVAL FOR THE QUARTERLY FILING OF FUEL OST ADJUSTMENT APPLICA-TIONS LEGAL NOTICE PUBLIC NOTICE is hereby given that on December 29, 2006, the Board of Directors or Utilities ("Board") of the Department of Public Utilities of the City of Indianapolis filed with the Indiana Utility Regula-tory Commission ("Commis-sion") its verified petition re-questing (i) authority to increase its rates and charges for steam utility service; (ii) approval of a new schedule of rates and charges applicable thereto; (iii) approval of cer-tain changes to its general terms and conditions for steam service; (iv) approval of new depreciation accrual rates; and (v) approval to file a quarterly fuel cost adjustment ("FAC") application in lieu of an annual FAC application. Pursuant to IC 8-1-11.1, the Board provides steam service to the public in the downtown and near downtown area in the City of Indianapolis, Indi-ana under the trade name "Citizens Thermal Energy." In its capacity as the municipal legislative body, the Board will adopt, subject to the approval of the Commission, a new schedule of just and reason-able rates and charges consis-tent with the revenue require-ment elements of IC 8-1.5-3-8. A copy of the Board=s petition is on file with the Commission

E PRESCRIBED FORMULA

ICA COLUMN - 94 POINT
NTS / 5.7 PT. TYPE - 16.49
EMS / 250 - .06596 SQUARES
SQUARES x $5.14 - .339 CENTS PER LINE

RATE PER LINE

PUBLISHED 1 TIME = .339
PUBLISHED 2 TIMES= .509
PUBLISHED 3 TIMES= .679
PUBLISHED 4 TIMES= .848

BEFORE THE

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS SUCCESSOR TRUSTEE OF A PUBLIC CHARITABLE TRUST, D/B/A CITIZENS THERMAL ENERGY FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR STEAM UTILITY SERVICE, (2) APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, (3) APPROVAL OF CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR STEAM SERVICE, (4) APPROVAL OF NEW DEPRECIATION ACCRUAL RATES, AND (5) APPROVAL FOR THE QUARTERLY FILING OF FUEL COST ADJUSTMENT APPLICATIONS.	)	**CAUSE NO. 43201**

DIRECT TESTIMONY
of
WILLIAM A. TRACY

On
Behalf of
Petitioner

Citizens Thermal Energy

Petitioner's Exhibit WAT

INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is William A. Tracy. My business address is 2020 North Meridian Street, Indianapolis, Indiana 46202.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Board of Directors for Utilities (the "Board") of the Department of Public Utilities (the "Department") of the City of Indianapolis (the "City"). The City is the successor trustee of a public charitable trust and, acting through the Board, manages and controls a number of businesses, including the municipally-owned steam utility of Citizens Thermal Energy that I will refer to as the "Steam System." I serve as Senior Vice President of Operations for the utilities and businesses under the Board's control.

Q. PLEASE BRIEFLY DESCRIBE YOUR PROFESSIONAL AND EDUCATIONAL BACKGROUND.

A. I was employed for over 30 years by Indianapolis Power & Light Company ("IPL") and its affiliates. I originally joined IPL in 1967 as an electrician at the Perry K steam plant located in Indianapolis, which was then owned by IPL. I advanced through positions of increasing responsibility, culminating in a promotion to Vice President of Thermal Systems. I also served as Vice President of Operations for Mid-America Energy Resources and Indianapolis Campus Energy and as President of Cleveland Energy Resources, all wholly-owned subsidiaries of IPL. During my employment with IPL, I attended Indiana

University Purdue University – Indianapolis focusing on engineering and management studies.

I became employed by the Board in 2001 as Vice President of Market Development after the Board acquired IPL's thermal energy assets. I was promoted to my current position in June 2005.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes. During my employment with IPL, I testified in several proceedings involving steam contracts. I also testified on behalf of IPL in Cause No. 41716, the proceeding in which this Commission approved the Board's acquisition of the steam business now operated by Citizens Thermal Energy, and on behalf of Citizens Thermal Energy in Cause No. 43025.

Q. PLEASE BRIEFLY DESCRIBE YOUR DUTIES AS SENIOR VICE PRESIDENT OF OPERATIONS AS THEY RELATE TO THIS PROCEEDING.

A. I have overall responsibility for the operation of the Steam System. That responsibility includes operations, sales and marketing, and business development.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. My testimony provides information in support of Petitioner's proposed increase to its base rates and charges.

OVERVIEW OF CITIZENS THERMAL ENERGY'S STEAM UTILITY BUSINESS

Q. PLEASE DESCRIBE CITIZENS THERMAL ENERGY'S STEAM UTILITY BUSINESS.

A. As explained by Mr. Lykins in his prepared testimony, the Board acquired the steam utility now operated by Citizens Thermal Energy from IPL in November 2000. The Steam System provides steam for heat and hot water to more than 200 buildings in the City of Indianapolis. It is one of the largest district steam systems in the United States, second only to the district steam system in New York City in terms of total annual steam sendout. Our customers include hospitals, manufacturing businesses, retailers and commercial office buildings. Unlike other utility services such as gas, electricity and water, district steam service is not available in all areas of the country. Our customers not only get the benefit of the low cost steam that the Steam System provides, they also avoid significant capital investments in steam boilers and related energy facilities required to produce their own steam. Businesses producing their own steam are also limited to a single fuel supply, usually natural gas. The Perry K steam plant utilizes five separate fuels to provide low cost steam to our customers. As a result, the availability of the steam service provided by the Steam System gives the City of Indianapolis and the

businesses that call Indianapolis home a competitive advantage.

Q. HOW WOULD YOU DESCRIBE THE PERFORMANCE OF CITIZENS THERMAL ENERGY NOW THAT IT HAS OPERATED THE STEAM UTILITY FOR OVER SIX YEARS?

A. I believe IPL operated the steam utility effectively and efficiently. For that reason, we have not made fundamental changes to the manner in which steam utility service is provided. That said, one of the core values our organization embraces is the pursuit of continual improvement. Consequently, Citizens Thermal Energy has undertaken a number of efforts to control costs and at the same time improve customer service, safety, reliability and efficiency since acquiring the utility in November 2000.

Q. CAN YOU PROVIDE SOME EXAMPLES OF CITIZENS THERMAL ENERGY'S EFFORTS TO CONTROL COSTS?

A. Certainly. The Steam System incurs costs to transport and dispose of sludge material that is created when hot lime and soda ash water are treated and processed at the Perry K plant. The cost for transporting this sludge is based on volume, with a large portion of the volume transported being water. In 2004, we purchased a sludge press machine to remove water from the sludge. The water that is removed from the sludge is pumped back into the system and reused at the Perry K plant. By removing water from the sludge prior to transporting and disposing it, Citizens Thermal Energy has significantly reduced the transportation

and disposal costs incurred. In fiscal year 2006, we estimate the sludge press reduced the utility's operating costs by $328,450.

Another project that has resulted in net savings for customers is the implementation of a polymer system that has significantly improved and largely automated the processes employed to prevent scale from accumulating in the Perry K plant's boilers. The polymer system has not only resulted in increased efficiency of the boilers (less fuel consumption), it is less labor intensive and has improved boiler availability by decreasing tube leaks. The polymer system, which was implemented in February 2006, requires the use of chemicals that increase operating expenses by approximately $114,000. However, the increased efficiency and boiler availability results in significant net savings for customers. There are many variables that affect boiler efficiency and availability, however, our estimated fuel savings achieved as a result of the polymer system during 2006 were $410,000.

Q. WHAT STEPS HAS CITIZENS THERMAL ENERGY TAKEN TO IMPROVE SAFETY?

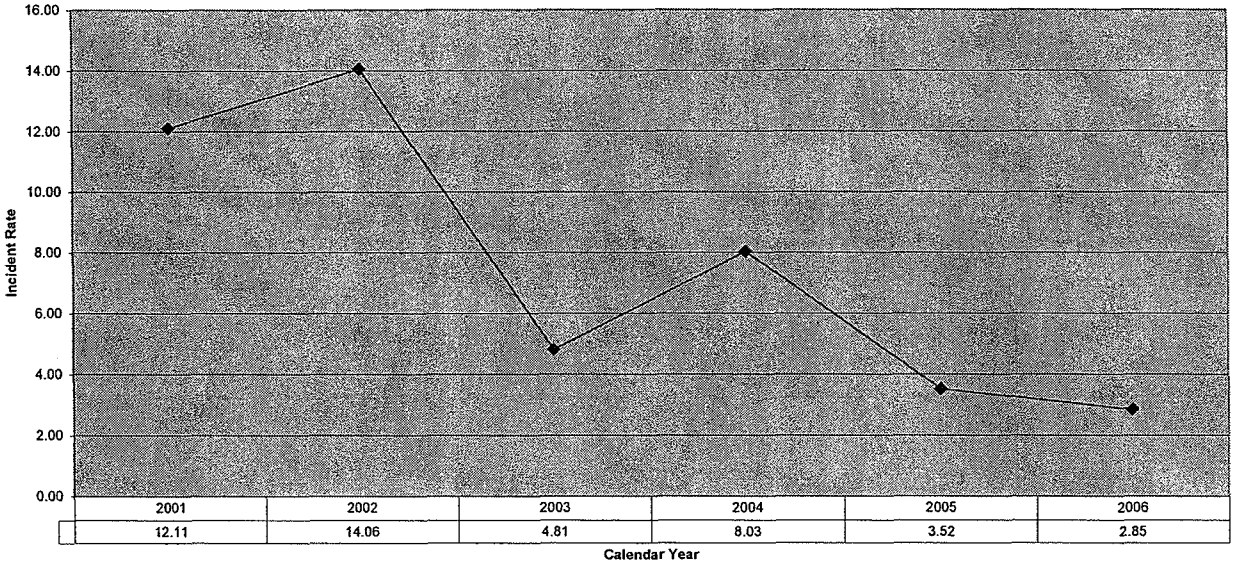
A. At the time Citizens Thermal Energy took over operations of the steam business, the steam utility was experiencing relatively high OSHA recordable incident rates, which measure the frequency of certain work related deaths, illnesses and injuries. As a result, we increased the utility's training efforts to address safety issues. Over the last several years, we also have taken a number of other steps to improve safety, including:

- Create a Safety Director position responsible for managing safety issues for all utilities and consolidation of all safety personnel in one Safety Department.
- Upgrade of incident management system to better track incidents that potentially could result in injury;
- Implement departmental safety meetings and operator qualification sign-offs;
- Review vendors to ensure employees have adequate protective equipment, such as safety eyewear, safety shoes and other specialty equipment;
- Implement safety award programs that recognize employees for working in a safe manner; and
- Create and train safety teams, including a Confined Space Rescue Team, which have performed safety audits and recommended new procedures and safer work practices.

Q. WHAT BENEFITS HAS THE UTILITY REALIZED AS A RESULT OF ITS INCREASED EMPHASIS ON SAFETY?

A. The most important benefit we have realized as a result of our increased emphasis on safety is that our employees are less likely to suffer work-related injuries today than they were in years past. The chart below shows the decrease in OSHA recordable incident rates Citizens Thermal Energy has experienced since 2001. While that chart includes incident rates from both the Steam System and chilled water operations, it accurately reflects the improved safety practices of the steam utility.

Citizens Thermal Energy OSHA Recordable Incident Rates
2001 - 2006



In addition to the benefit of protecting our employees, improved safety has financial consequences as well. Serious work-related injuries can result in significant claims that drive up the cost of operating the utility. Consequently, not only is improving safety for our employees simply the right thing to do, it ultimately reduces the cost of supplying steam to our customers.

Q. WHAT STEPS HAS CITIZENS THERMAL ENERGY TAKEN TO IMPROVE CUSTOMER SERVICE?

A. We have taken a number of steps to improve communications with our customers and responsiveness to their needs. In April 2003, we began publishing a quarterly newsletter, *Citizens Thermal Update*, that offers reviews of new technology, suggestions about system maintenance and ways to save money. We also hold annual customer luncheon seminars at which presentations on topics of interest to

our customers are made. Finally, we offer on-site training to our customers to help them maximize the value of the steam services we provide.

In October 2006, we implemented new software that improves meter reading, data acquisition and billing processes. In addition to improving audit capabilities, the new system has reduced the time it takes to process complex bills for large customers from five days to just one day.

Q. HOW HAVE CUSTOMERS REACTED TO CITIZENS THERMAL ENERGY'S OPERATION OF THE STEAM BUSINESS?

A. From all indications, our customers are pleased overall with the service Citizens Thermal Energy is providing. Each year, Citizens Thermal Energy conducts a Customer Loyalty Survey. According to the most recent assessment, customers rated service quality significantly higher than past years, and the percentage of customers who are considered truly loyal (based largely on customers' belief that Citizens Thermal Energy cares about its customers) is at an all-time high. The Customer Loyalty Survey identifies strengths and areas for improvement.

The results of this assessment are used as part of a larger quality improvement initiative that is based on the Malcolm Baldridge Quality Criteria and conducted annually by an independent examiner. The Baldridge approach is an integrated management framework that addresses all the factors that define an organization, its operations and its results. This integrated approach ensures that changes designed to improve one area, such as efficiency, are not made without considering the effects to another area, such as customer service. Continuous

improvement, which, as mentioned above, is one of our organization's core values, is an underlying philosophy of the Baldridge Quality Criteria and self-assessment process.

FUTURE CHALLENGES AND NEED FOR INCREASE TO BASE RATES AND CHARGES

Q. WHAT ARE THE MAJOR CHALLENGES THE STEAM SYSTEM FACES?

A. The age of the Perry K production plant as well as the steam distribution system is a major challenge. The Perry K plant was originally constructed in the early 1900s, and the eight boilers used to produce steam range in age from 33 to 70 years. Likewise, a significant amount of our steam distribution system has lasted beyond its expected life. As discussed by Mr. Dillard, upgrading and maintaining this aging plant and steam distribution system has and will continue to require significant expenditures on an ongoing basis.

Complying with increasingly stringent environmental regulations is also a concern. Mr. Dillard discusses in detail rules promulgated by the EPA regulating air emissions from the coal-fired boilers at the Perry K plant. Citizens Thermal Energy is on target to achieve compliance with those rules ahead of schedule. As explained in the prepared testimony of Mr. Brehm, Citizens Thermal Energy will be able to complete the $14,000,000 investment required to comply with those rules without having to incur additional debt. Moreover, as explained by Mr. Dillard, because we do not at this time view those expenditures as ongoing in nature, no amount is reflected in our revenue requirement for extensions and

replacements related to that investment. However, other future environmental regulations that could affect the Perry K plant are certainly possible, if not likely, and the financial challenge of complying with any such regulations complicates our long-term resource planning.

Similarly, fuel supply planning is another major challenge we face. The cost of fuel represents a large percentage of the cost our customers pay for steam. We recently reduced a significant amount of uncertainty with respect to both resource and fuel-supply planning by completing the negotiation of a long-term supply arrangement for the purchase of steam from Covanta Indianapolis, Inc., which produces approximately 46 percent of our steam supply at its Indianapolis waste to energy facility. Without the steam purchased from Covanta, our fuel costs as well as other operating and maintenance costs would rise significantly. Notwithstanding the completion of the Covanta steam purchase agreement, fuel supply planning remains a challenge, and we will continue to strive to control the Perry K plant's fuel and other operating costs.

With respect to all of those challenges, I believe it makes sense for Citizens Thermal Energy to collaborate with its customers and other interested stakeholders regarding the Steam System's long-term planning processes. On that note, I affirm Citizens Thermal Energy's commitment to comply fully with the Commission's directive in Cause No. 43025 to engage interested parties in discussions regarding Citizens Thermal Energy's long-term resource planning. We are planning to present to the Staff of the Commission and the OUCC, as well

as other interested parties, our long-term plans for the Steam System, including information regarding our long-term steam resource production work plans, long-range production forecast and other issues that could significantly impact the business and our customers.

CONCLUSION

Q. AS PETITIONER'S SENIOR VICE PRESIDENT OF OPERATIONS, WHAT IS YOUR OPINION REGARDING THE NECESSITY OF THE RATE RELIEF CITIZENS THERMAL ENERGY HAS REQUESTED IN THIS PROCEEDING?

A. For the reasons described in my testimony and in the testimony of the other witnesses who will testify on behalf of Citizens Thermal Energy in this proceeding, I believe that the proposed two-step increase to the Steam System's revenue requirement, resulting in a 12.5 percent increase to base rates and charges effective before December 1, 2008, and an incremental 5.1 percent increase to base rates and charges effective on and after December 1, 2008, is reasonable and just and should be approved. The proposed rates and charges are necessary to produce income sufficient to ensure the Steam System can maintain its plant in a sound physical condition and maintain the financial strength required to render adequate and efficient service.

Q. DOES THAT CONCLUDE YOUR PREPARED DIRECT TESTIMONY?

A. Yes, it does.

VERIFICATION

STATE OF INDIANA)
) ss:
COUNTY OF MARION)

The undersigned, William A. Tracy, under penalties of perjury and being first duly sworn on his oath, says that he is Senior Vice President of Operations for Citizens Thermal Energy; that he caused to be prepared and read the foregoing Direct Testimony; and that the representations set forth therein are true and correct to the best of his knowledge, information and belief.

Wm A Tracy

By: William A. Tracy
Senior Vice President of Operations
Citizens Thermal Energy

Subscribed and sworn to before me, a Notary Public, this 30 day of March, 2007.

Patricia A. Decker
Signature

Patricia A. Decker
Printed Name

My Commission Expires: May 29, 2008

My County of Residence: Marion

BEFORE THE

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS SUCCESSOR TRUSTEE OF A PUBLIC CHARITABLE TRUST, D/B/A CITIZENS THERMAL ENERGY FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR STEAM UTILITY SERVICE, (2) APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, (3) APPROVAL OF CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR STEAM SERVICE, (4) APPROVAL OF NEW DEPRECIATION ACCRUAL RATES, AND (5) APPROVAL FOR THE QUARTERLY FILING OF FUEL COST ADJUSTMENT APPLICATIONS.	)	**CAUSE NO. 43201**

DIRECT TESTIMONY AND EXHIBIT
of
JAMES O. DILLARD

On
Behalf of
Petitioner

Citizens Thermal Energy

Petitioner's Exhibit JOD

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is James O. Dillard. My business address is 366 Kentucky Avenue, Indianapolis, Indiana.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Board of Directors for Utilities (the "Board") of the Department of Public Utilities (the "Department") of the City of Indianapolis (the "City"). The City is the successor trustee of a public charitable trust and, acting through the Board, manages and controls the business of Citizens Thermal Energy, the Petitioner in this proceeding. I hold the position of General Manager, Facilities and Engineering, for Citizens Thermal Energy.

Q. WHAT ARE YOUR RESPONSIBILITIES IN THAT POSITION?

A. I am responsible for the oversight of Citizens Thermal Energy's utility management operations and the engineering resources associated with Citizens Thermal Energy's steam and chilled water operations. Throughout my testimony, I will refer to the steam utility operated by Citizens Thermal Energy as the "Steam System."

Q. HOW LONG HAVE YOU HELD THAT POSITION?

A. I was named to my current position on November 28, 2005.

Q. WHAT OTHER POSITIONS HAVE YOU HELD PRIOR TO ASSUMING YOUR CURRENT POSITION?

A. I served as Assistant General Manager for Citizens Thermal Energy beginning in November 2000, which was when the Board acquired the steam assets from Indianapolis Power & Light Company ("IPL"). Prior to that acquisition, I was employed for over 24 years by IPL, serving most recently as Director of Engineering for its steam operation.

Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. I have a Bachelor of Science Degree in Mechanical Engineering from Purdue University and a Masters in Business Administration from Anderson University. I am a registered Professional Engineer in the State of Indiana, and I have a State of Indiana Certification as a Waste Treatment Plant Operator (Industrial Class A). I am currently an active member in ASHRAE (Association of Heating Refrigeration, and Air Conditioning Engineers), the IDEA (International District Energy Association), and the ICR (Indiana Construction Roundtable).

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes. I previously testified in Cause No. 43025 regarding the approval and cost recovery of a steam purchase agreement that the Steam System entered into with Covanta Indianapolis, Inc. ("Covanta"). I also submitted prepared testimony in Cause No. 43117 regarding the approval of a power purchase agreement between the Steam System and IPL.

Q. WHAT IS THE PURPOSE FOR YOUR TESTIMONY IN THIS PROCEEDING?

A. My testimony supports the relief requested by Petitioner in the December 29, 2006, Petition initiating this proceeding. Specifically, I will explain the Steam System's policies and processes related to extensions and replacements expenditures and the amount of extensions and replacements investment required on an ongoing basis to maintain the Steam System in a sound physical condition to render adequate and efficient service. I also will discuss certain *pro forma* adjustments that are shown in Petitioner's Exhibit LSP-1 and further described by Petitioner's witness LaTona S. Prentice.

EXTENSIONS AND REPLACEMENTS

Q. WHAT ARE THE MAJOR COMPONENTS OF THE STEAM SYSTEM'S ONGOING EXTENSIONS AND REPLACEMENTS PROGRAM?

A. The Steam System's plant is primarily categorized as steam production plant and steam distribution plant. Those two categories of plant are the major components of the Steam System's ongoing extensions and replacements program. Additionally, on an ongoing basis, the Steam System expends funds for extensions and replacements of general plant necessary to render steam service to its customers.

Q. PLEASE GENERALLY DESCRIBE THE STEAM PRODUCTION PLANT.

A. The steam production plant consists of the facilities and equipment located at the Perry K steam generating plant in downtown Indianapolis. The Perry K plant includes eight boilers that utilize a variety of fuels to make steam. The Perry K plant consists of various other facilities, including water treatment equipment, two

turbines used to generate electricity and coal and ash handling equipment. The majority of the Steam System's steam supply is produced by the Perry K steam production plant. The remainder of the steam supply is purchased from Covanta, which produces steam at the Indianapolis Resource Recovery Facility ("IRRF").

The Perry K steam plant was originally built in the early 1900s as an electric generating station. Through the years, the Perry K plant evolved into a district steam production facility serving one of the largest district steam systems in the United States. The eight boilers in the facility range in age from 33 to 70 years old. The Perry K plant's capacity is approximately two-million pounds of steam per hour, with an additional 400,000 pounds of steam per hour of capacity available from Covanta's IRRF. As discussed by Petitioner's witness William A. Tracy, the eight boilers at the Perry K plant can burn a variety of fuels including natural gas, coal, coke oven gas, and No. 2 Fuel Oil.

Q. PLEASE GENERALLY DESCRIBE THE STEAM DISTRIBUTION PLANT.

A. The steam distribution plant is used to deliver steam produced at the Perry K plant, or purchased from Covanta, to the Steam System's customers throughout the City of Indianapolis. The steam distribution system includes underground steam lines, services, meters and other related facilities. The Steam System has approximately 23 miles of underground steam lines varying in size from one inch to 24 inches in diameter.

Q. PLEASE DESCRIBE THE STEAM SYSTEM'S GENERAL PLANT.

A. The Steam System utilizes a variety of general plant to provide service, including general office and plant facilities and equipment, security equipment and facilities, conventional office equipment, computer systems and related equipment and software, communications facilities, safety equipment and operational tools.

Q. PLEASE DESCRIBE THE PROCESS USED TO DETERMINE THE AMOUNT OF EXTENSIONS AND REPLACMENTS EXPENDITURES THAT THE STEAM SYSTEM WILL MAKE ON AN ONGOING BASIS.

A. A structured planning and resource allocation process is followed, which includes setting strategic and operational initiatives, planning and budgeting, and budget approval. This process begins prior to February each year with executive management establishing strategic objectives for the Steam System and other businesses under the Board's control. From February through April, financial targets are developed, customer needs are identified, operational planning is conducted, resource requirements are identified, and strategies and budgets are prepared, reviewed and discussed. All extensions and replacements expenditures are based on and designed to support customer, operational and financial objectives. In July, major strategies and the final budget are prepared and approved by the resource planning group, the budget department and executive management. The budget is then presented to the Board for final review and approval in September. Throughout the year, the extensions and replacements budget is managed based on actual operational and financial performance and adjusted as necessary. For example, the extensions and replacements budget may

be adjusted to account for the effects of warmer than normal temperatures and other unplanned occurrences.

Q. PLEASE DESCRIBE THE TYPES OF EXPENDITURES THAT THE STEAM SYSTEM MAKES FOR PRODUCTION PLANT EXTENSIONS AND REPLACEMENTS ON AN ONGOING BASIS.

A. The Steam System must expand, upgrade, relocate, replace and retire facilities and equipment at its Perry K production plant and within the steam distribution system on an ongoing basis. The steam production plant is an old facility that requires upgrades and improvements to maintain its effectiveness, efficiency, and reliability. The plant itself is over a century old. The existing boilers range in age from 33 to 70 years. The electric generators are 70 and 83 years of age, while the equipment that makes up the water treatment system ranges in age from 47 to 60 years. The oldest remaining structure is the dam across White River, which is approximately 90 years old. While the equipment is old, it has been improved and modernized through prudent use of funds for extensions and replacements. The boilers themselves are original equipment, but components or sections of the boilers wear and require periodic replacements. Coal-handling equipment also requires periodic replacement. Coal and coal ash by their nature are both corrosive and very abrasive. Coal conveyors, hoppers, feeders, fans, blowers, burners, pulverizers, and boiler tubes all are subject to continual wear and corrosion as a result of the harsh operating environment. This equipment is inspected and repaired as needed on an annual basis. Equipment is replaced when

the replacement is more cost effective than continued maintenance or repair of the existing equipment or when replacement parts are not available due to the age of the equipment.

Instrumentation is another area that annually requires capital for extensions and replacements. Through the years, the technology of boiler control systems has progressed and improved. The original control systems were mechanical (arms and levers) systems, which were replaced by pneumatic (compressed air) systems. The pneumatic systems progressed to analog (electrical) systems, and, currently, the Steam System is gradually moving to computer-based digital instrument systems. Extension and replacement projects related to instrumentation improve the reliability of the boiler control systems, and also can reduce manpower requirements and maintenance costs. Digital controls also improve the fuel efficiency and turn down rates of the power plant. For the twelve months ending September 30, 2006, the total expenditures for production plant extensions and replacements were $6,764,921.

Q. PLEASE DESCRIBE THE TYPES OF EXPENDITURES THAT THE STEAM SYSTEM MAKES FOR DISTRIBUTION PLANT EXTENSIONS AND REPLACEMENTS ON AN ONGOING BASIS.

A. The Steam System must expand, upgrade, relocate, replace and retire facilities and equipment that make up its distribution plant on an ongoing basis. For the twelve months ending September 30, 2006, the total expenditures for distribution plant extensions and replacements were $1,076,461. Expenditures for the

distribution system can be divided into three general areas: (1) expenditures for new services or main extensions to supply the steam needs of new steam customers and meet the needs of existing customers that are increasing their steam requirements, (2) expenditures for replacement of existing steam mains and manholes, and (3) expenditures for tools, trucks, and equipment used to maintain the steam distribution system. The steam business typically adds one to three new buildings to our system each year. For example, in 2006, this category totaled $489,323 in expenditures, which was primarily driven by service line installations to three new customers.

The second area described above relates to replacement of equipment that has failed or reached the end of its useful life. The steam distribution system is a mechanical system that literally shrinks and expands constantly as the steam temperature changes. The constant and frequent movement takes a toll on the mechanical components of the system and eventually requires that those components be retired and replaced. In addition, the hot, moist environment of steam manholes causes corrosion of the mechanical systems that eventually leads to the need for replacements of manholes and steam line components. The Steam System's distribution system includes approximately 650 manhole structures. Typically, a manhole will have an expected life of approximately 50 years. At that pace, we need to replace approximately 13 manholes each year at an estimated cost of $30,000 per manhole. That replacement schedule alone requires approximately $400,000 per year for manhole structure rebuilds.

In addition to manhole replacements, sections of mains, expansion joints, valves, anchors, and other steam line components are retired and replaced each year. The cost of repairing leaks in steam lines and replacing sections of steam mains represents a significant portion of the annual capital budget. For example, in 2006, the Steam System spent $587,138 for the retirement and replacement of steam line components. The steam line leak identification and repair process is an ongoing process for the steam business. A list of known leaks is maintained and a priority is assigned to each leak based on the amount of steam leaking and the associated hazards with the leak. Leaks that have the potential of creating safety hazards for customers or the public get first or immediate replacement priority. The second-highest priority is assigned to leaks that are resulting in significant energy losses but do not pose a safety hazard. Finally, relatively small leaks that are not creating any safety related problems are given a lower priority.

The majority of leaks that are repaired are handled through maintenance expense accounts. However, if significant sections of mains or large mechanical components are replaced, the charges are accumulated as capital expense items.

Q. HOW ARE STEAM LEAKS IDENTIFIED?

A. Leaks are identified through customer contacts, observation by Steam System personnel, or annually through a contract with a third party for an infrared scan of the distribution system. An infrared camera detects hot spots or potential steam leaks on the street surface and identifies the relative magnitude of the potential leaks. The hot spots are cataloged and cross-checked with previously identified

leaks in the system. New areas are identified, prioritized, and added to the steam leak inventory and scheduled to be repaired based on the priorities described above

Q. PLEASE DESCRIBE THE TYPES OF EXPENDITURES THAT THE STEAM SYSTEM MAKES FOR GENERAL PLANT EXTENSIONS AND REPLACEMENTS ON AN ONGOING BASIS.

A. The Steam System also must invest in its general plant in order to continue providing adequate service to customers on an ongoing basis. Such investments include expenditures to expand, upgrade, relocate, replace and retire general office and plant facilities and equipment, security equipment and facilities, conventional office equipment, computer systems and related equipment and software, communications facilities, safety equipment and operational tools. For the twelve months ending September 30, 2006, the total expenditures for general plant extensions and replacements were $645,957.

Q. PETITIONER'S EXHIBIT JOD-1, LINE 9, COLUMN E REFLECTS AN OFFSET TO THE TEST YEAR EXTENSIONS AND REPLACEMENTS FOR MACT E&R. PLEASE EXPLAIN THAT OFFSET.

A. The amount of Petitioner's test year expenditures for extensions and replacements was reduced by $4,640,742 to determine the proposed pro forma extensions and replacements revenue requirement of $3,846,597 in recognition of our belief that expenditures related to the Steam System's environmental compliance program do not reflect ongoing operations at this time.

as (1) converting the boilers to natural gas, (2) adding acid gas scrubbers and baghouses to the existing coal-fired boilers, or (3) building new, state-of-the-art fluidized bed coal-fired boilers.

In an effort to identify a less costly solution and mitigate the impact of the MACT standards on the Steam System's customers, internal plant personnel conducted a series of coal tests and other analysis. The Steam System then engaged Burns & McDonnell to assist with the development of an alternative scenario that built on the work previously done by Duke/Fluor-Daniel and the testing and analysis performed by our own employees. As a result of that work, a solution was identified that required a variety of capital projects to modify the coal-fired boilers to reduce emissions and improve combustion efficiency to achieve compliance with the new MACT standards. The MACT compliance project is being completed over a two year period. The first year is complete, and preliminary testing indicates that the plant modifications will achieve the targeted emission reductions. The entire cost of the MACT compliance project is approximately $14,000,000.

Q. PLEASE GENERALLY DESCRIBE THE MODIFICATIONS BEING MADE AS PART OF THE MACT COMPLIANCE PROGRAM.

A. Compliance with the particulate matter limits in the MACT standards required a much larger electrostatic precipitator to be installed on the No. 12 Boiler, which is a coal-fired boiler. The most cost effective option to expand the size of the electrostatic precipitator was to utilize precipitator equipment abandoned in place

when the No. 14 Boiler was converted to natural gas in 1998. Installing that precipitator also required extensive modifications to duct work, fan, and boiler control equipment. In addition, both precipitators now serving No. 12 Boiler were refurbished and modernized using current electrostatic precipitator technology.

New burners (so-called "low NOx burners") also will be installed on the No. 12 Boiler. The low NOx burners will improve the combustion efficiency of the boiler and reduce nitrogen oxide emissions, a precursor to the formation of ground-level ozone, a pollutant for which the Central Indiana region has historically been designated by the EPA as non-attainment because the air quality in Central Indiana exceeded the standards set by the EPA.

The third facet of the MACT compliance project is to improve the combustion efficiency and emissions controls on the Nos. 15 and 16 stoker-fired Boilers to meet the MACT particulate emission limits. The combustion efficiency improvements not only will lower fuel costs (because the boilers will be capable of producing the same volume of steam while combusting less fuel), but also will reduce the flue gas temperatures going into the electrostatic precipitators, which will improve the ability of that equipment to remove particulate matter from the flue gas stream.

Q. YOU STATED THAT THE MACT COMPLIANCE PROJECT IS NOT REFLECTIVE OF ONGOING OPERATIONS AT THIS TIME. DOES THAT MEAN YOU DO NOT EXPECT THE STEAM SYSTEM TO INCUR

ADDITIONAL EXPENDITURES TO ACHIEVE COMPLIANCE WITH OTHER RULES RELATED TO EMISSION REDUCTIONS OR OTHER ENVIRONMENTAL CONCERNS?

A. No. There is a very real possibility that additional and more stringent rules will be established that could affect the Perry K plant. The Clean Air Act requires the EPA to evaluate the ambient air quality standards every five years to ensure that they are sufficiently protective of public health. The air quality standards for particulate matter were made more stringent in 2006, and the air quality standards for ozone currently are being evaluated by the EPA. Initial recommendations from the advisory panels to the EPA are to lower the ozone standards significantly. While we believe the current initiatives and upgrades will bring the plant into compliance with current rules, the State and Federal environmental agencies are likely to develop additional rules in the future to achieve the more stringent ambient air quality standards. Although there is much uncertainty regarding environmental issues affecting the Steam System, we recognize that expenditures are likely to be required.

Q. MR. DILLARD, DO YOU HAVE AN OPINION REGARDING THE AMOUNT THE STEAM SYSTEM SHOULD INVEST ANNUALLY ON AN ONGOING BASIS IN EXTENSIONS AND REPLACEMENTS FOR ITS PRODUCTION PLANT, DISTRIBUTION PLANT AND GENERAL PLANT?

A. Yes. In my opinion, the annual revenue requirement for extensions and replacements should be $3,846,597. The foregoing amount required for ongoing extensions and replacements is the amount that was invested for extensions and replacements during the twelve months ended September 30, 2006 of $8,487,339, less expenditures for the MACT compliance program of $4,640,742. In my opinion, the amount of $3,846,597 is reflective of ongoing operations and the amount the Steam System needs to invest annually in extensions and replacements for its production plant, distribution plant and general plant in order to maintain the Steam System in a sound physical condition to render adequate and efficient steam service. As shown on Petitioner's Exhibit JOD-1, the proposed revenue requirement amount of $3,846,597 is consistent with the historical average of extensions and replacements expenditures for the last five fiscal years, which includes the test year in this proceeding.

Q. WHAT CHALLENGES WILL THE STEAM SYSTEM FACE IF ITS ANNUAL REVENUE REQUIREMENT DOES NOT INCLUDE AN ADEQUATE AMOUNT FOR EXTENSIONS AND REPLACEMENTS?

A. The age of the Perry K production plant, as well as much of the Steam System's distribution system, is a challenge in and of itself. If the Steam System's annual revenue requirement does not include adequate funds for making extensions and replacements to those aging systems, that challenge will be exacerbated. In general, the funding for extensions and replacements allows us to maintain the reliability and viability of our system. Over time, if the funds available for

extensions and replacements are not adequate, customers will experience more frequent episodes of steam outages and losses of system steam pressure. If the Steam System is not properly maintained and invested in, it will not be feasible to operate the Steam System due to excessive maintenance costs, safety concerns and the inability to operate obsolete equipment.

SUPPORT FOR CERTAIN PRO FORMA ADJUSTMENTS

Q. HAVE YOU REVIEWED THE PREPARED TESTIMONY AND EXHIBITS SPONSORED BY PETITIONER'S WITNESS PRENTICE?

A. Yes, I have.

Q. MS. PRENTICE MADE PRO FORMA ADJUSTMENTS TO REFLECT THE STEAM SYSTEM'S PUMP REBUILDING PROJECT AND ELECTRICAL SYSTEM UPDGRADE PROGRAMS. PLEASE DESCRIBE THOSE PROGRAMS.

A. The Perry K plant has twelve boiler feed pumps that supply feedwater to the boilers. Our experience indicates that we can expect these pumps to operate approximately seven years with only minor maintenance and cleaning activities. Beyond the seven-year time frame, the pumps require major and expensive rebuilds and overhauls. Going forward, we are implementing an overhaul and rebuilding cycle of seven years for the boiler feed pumps. Given the increasing age of the pumps and the increasing cost of replacement parts, the pro forma adjustment reflects an increase of $65,339 for this pump category of maintenance expenses.

The plant maintenance staff performs similar preventative maintenance activities with respect to the plant's major electrical components. The high-voltage electrical switchgear are going to be put on a three year clean, inspect, and test schedule. During this process, potential safety or operating problems will be identified and corrected as necessary. Much of this switchgear repair work must be completed during short boiler outage time periods, which requires the use of specialized contractors with the skills, tools, and test equipment to complete the work in the time frame allowed. Similar to the situation with the pumps, this accelerated maintenance and overhaul schedule, along with the aging equipment, and increasing cost of replacement parts will result in additional expenditures for both the electrical systems and to a limited extent the contracted services categories. The balance of the pro forma increase to contracted services relates to an increasing need for contracted services, to shorter boiler outage periods, and the general aging of the plant and equipment.

Q. MS. PRENTICE ALSO MADE A PRO FORMA ADJUSTMENT FOR EXPENSES ASSOCIATED WITH RENTING FACILITIES FROM THE GAS DIVISION TO HOUSE THE STEAM SYSTEM'S OPERATING CREWS AND EQUIPMENT. PLEASE DESCRIBE THE NEED TO RENT THOSE FACILITIES.

A. In 2006, the Steam System moved the base of operations for its distribution operating and maintenance crews to the Gas Division's Langsdale operating center. This relocation was required because there simply was not adequate space

for the crews and their equipment and vehicles at the Steam System's other facilities, especially in light of the construction equipment and personnel working at the Perry K plant to complete the MACT compliance program. The Langsdale facility has security and other features that are needed for the type of equipment and personnel that is housed there. Even if we could have found suitable space at another location near the downtown area, the cost for such space likely would have been higher than the cost of renting space at the Langsdale facility. Moreover, we anticipate that in the future, we will be able to recognize cost savings and synergies by sharing personnel, tools, and other resources with the Gas Division's distribution, operating and maintenance crews.

Q. MS. PRENTICE ALSO MADE A PRO FORMA ADJUSTMENT REMOVING REVENUES GENERATED FROM SALES OF ELECTRICITY FROM THE TEST YEAR REVENUES. HOW OFTEN DO YOU ANTICIPATE THE STEAM SYSTEM WILL UTILIZE ITS ELECTRIC GENERATORS TO PRODUCE ELECTRICITY TO BE SOLD?

A. The Perry K plant has one turbine (the No. 4 Turbine) that under certain circumstances can be used to generate electricity that is sold to IPL. There are three situations that could result in the operation of the No. 4 Turbine for the wholesale production of electricity. The first situation would be as a result of IPL needing additional electric generation in unusual or emergency conditions. In this situation, IPL would call and request that we operate the unit for a limited period

of time until the emergency or unusual conditions are resolved. This historically has occurred on very rare occasions for just a few hours per year. The second situation involves the use of excess Covanta steam production beyond what is needed for distribution by the Steam System. If the Steam System has excess Covanta-produced steam, it is used in the No. 4 Turbine to produce electricity for sale to IPL. This situation is also becoming relatively infrequent given the increasing steam quantities that have been used for the production of chilled water during the warm weather seasons. Finally, under certain circumstances, operating Unit No. 4 provides operational benefits related to the boilers used to produce steam, and the Steam System may dispatch the unit for that reason.

CONCLUSION

Q. WAS PETITIONER'S EXHIBIT JOD-1 PREPARED BY YOU OR UNDER YOUR SUPERVISION?

A. Yes, it was.

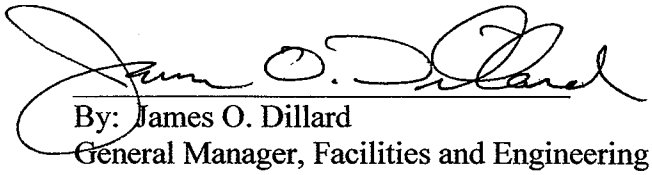
Q. DOES THAT CONCLUDE YOUR PREPARED CASE-IN-CHIEF TESTIMONY?

A. Yes it does.

VERIFICATION

STATE OF INDIANA)
) ss:
COUNTY OF MARION)

The undersigned, James O. Dillard, under penalties of perjury and being first duly sworn on his oath, says that he is General Manager, Facilities and Engineering for Citizens Thermal Energy; that he caused to be prepared and read the foregoing Direct Testimony; and that the representations set forth therein are true and correct to the best of his knowledge, information and belief.



By: James O. Dillard
General Manager, Facilities and Engineering
Citizens Thermal Energy

Subscribed and sworn to before me, a Notary Public, this 30th day of March, 2007.

Signature

Kim M. Potochnik
Printed Name

My Commission Expires: Sept. 28, 2009

My County of Residence: Marion Co.
Indiana

Citizens Thermal Energy
IURC Cause No. 43201
Petitioner's Exhibit JOD-1

Citizens Thermal Energy
5 - Year Comparison of Extensions & Replacements

Line No.		A FY 2002	B FY 2003	C FY 2004	D FY 2005	E FY 2006	F 5 year Avg
1	Production	$ 3,868,094	$ 3,101,906	$ 1,076,396	$ 2,198,669	$ 6,764,921	$ 3,401,997
2	Distribution	658,518	586,529	943,391	1,065,105	1,076,461	$ 866,001
3	General Plant	$ 50,046	$ 2,246	$ -	$ 83,264	$ 645,957	$ 156,303
4	Total Extensions & Replacements	$ 4,576,658	$ 3,690,681	$ 2,019,787	$ 3,347,038	$ 8,487,339	$ 4,424,301
5	Less MACT E & R	$0	$0	$0	$259,607	$4,640,742	
6	Net Extensions & Replacements	$ 4,576,658	$ 3,690,681	$ 2,019,787	$ 3,087,431	$ 3,846,597	$ 3,444,231

BEFORE THE

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS SUCCESSOR TRUSTEE OF A PUBLIC CHARITABLE TRUST, D/B/A CITIZENS THERMAL ENERGY FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR STEAM UTILITY SERVICE, (2) APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, (3) APPROVAL OF CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR STEAM SERVICE, (4) APPROVAL OF NEW DEPRECIATION ACCRUAL RATES, AND (5) APPROVAL FOR THE QUARTERLY FILING OF FUEL COST ADJUSTMENT APPLICATIONS.	)	**CAUSE NO. 43201**

DIRECT TESTIMONY AND EXHIBITS OF JOHN R. BREHM

On Behalf of Petitioner,
Citizens Thermal Energy

Petitioner's Exhibit JRB

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is John R. Brehm. My business address is 2020 North Meridian Street, Indianapolis, Indiana.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Board of Directors for Utilities, d/b/a Citizens Gas & Coke Utility and d/b/a Citizens Thermal Energy ("Citizens" or the "Utility"), as its Sr. Vice President and Chief Financial Officer.

Q. PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES.

A. As Chief Financial Officer, my duties include overall responsibility for Citizens' financial functions.

Q. HOW LONG HAVE YOU BEEN EMPLOYED BY CITIZENS?

A. I have been employed by Citizens since March of 2005.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I graduated from Indiana State University in 1975 with a degree of Bachelor of Science in Accounting. I also am a Certified Public Accountant.

Q. PLEASE DESCRIBE YOUR PRIOR BUSINESS EXPERIENCE.

A. I worked for Indianapolis Power & Light Company ("IPL") from June 1972 through March 2001, including the first three and one-half years as an accounting co-op student. During my co-op period of employment, I engaged in various accounting tasks in IPL's Financial and Special Reports Division. Upon my full time employment with IPL in 1976, I worked consecutively as an accountant in the Controller Organization and as a Financial Analyst in the Treasurer

Organization. From November 1978 to May 1980, I was Supervisor of the Budget and Forecasting Division. From May 1980 to May 1981, I was Director, General Accounting Department. In May 1981, I was elected Assistant Controller of IPL where I was responsible to the Vice President and Controller for overseeing the work customarily performed within an electric utility controller function, including the preparation of internal and external financial statements, tax returns, the annual operating budget, long-range financial forecasts and accounting exhibits presented to regulatory bodies, including the Indiana Utility Regulatory Commission ("Commission"). In 1987, I was elected Treasurer of IPL. In that capacity, under the supervision of the Executive Vice President, I was responsible for recommending, coordinating and implementing security offerings, the daily cash management of funds including short-term borrowings and short-term investments and other related treasury functions.

In April 1989, I was elected Senior Vice President – Financial Services of IPL; in 1991 I was elected Senior Vice President – Finance and Information Services of IPL; and in April 1998 I was elected Senior Vice President – Finance of IPL. In those capacities, among other duties, I assisted in the formulation of financial policy and directed and coordinated the financial and accounting activities of IPL. I also directed the Controller and Treasurer in the performance of their duties. I was responsible for coordinating, reviewing and approving all major accounting and treasury changes, reports and financial strategies to facilitate the financial management of IPL. I also supervised staff preparation for

registration, issuance and sale of securities. Additionally, I set policy and supervised preparation for financial proceedings before all regulatory bodies, including cases to establish basic rates and charges and fuel adjustment charge proceedings that were presented before the Commission. In that capacity I testified before the Commission on numerous occasions.

From April 1989 to March 2001, I also served as Vice President and Treasurer of IPALCO Enterprises, Inc. ("IPALCO") and was the chief financial officer ("CFO") of both IPALCO and IPL.

From April 2001 to June 2004, I worked as an independent utility consultant providing professional services in a variety of areas, including financial matters, regulatory matters and planning. In that capacity I testified before the Commission as an expert witness.

From June 2004 through March 2005, I served as the Chief Operating Officer of the Indiana Humanities Council, a nonprofit organization dedicated to strengthening Indiana communities through targeted initiatives in leadership, education and culture.

From March 2005 to date, I have served as the Senior Vice President & Chief Financial Officer of Citizens. In that capacity I assist in the formulation of financial policy and direct and coordinate the financial and accounting activities of Citizens. I also direct the Controller, Treasurer and Director of Risk Management in the performance of their duties. I am responsible for coordinating, reviewing and approving all major accounting and treasury

activities, reports and financial strategies to facilitate the financial management of Citizens. In that capacity I testified before the Commission in Cause No. 42767, the most recent Citizens Gas & Coke Utility gas rate case.

Q. WHAT HAVE YOU DONE TO PREPARE YOURSELF TO TESTIFY IN THIS PROCEEDING ON BEHALF OF CITIZENS?

A. As Chief Financial Officer I have ultimate responsibility for Citizens' financial statements, including the test year "Statement of Operations" or income statement and "Statement of Financial Position" or balance sheet for the Steam System. In the normal course of preparing such statements, I met with certain members of the Utility's accounting staff who are responsible for making entries on the Utility's books and records, as well as those responsible for financial statement preparation, in order to understand the data presented in the financial statements. In addition, in the normal course of my duties I have become familiar with Citizens' internal control procedures related to financial statements. I have read the petition and the direct testimony and exhibits Citizens filed on April 2, 2007 in this proceeding. I have also familiarized myself with certain parts of the statute that governs ratemaking for Citizens.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to provide support for and sponsor the test year income statement and balance sheet for the Steam System, as well as certain pro forma adjustments to amounts on the balance sheet. I also sponsor the pro forma

adjustments to the test year allocation of Corporate Support Services costs to the Steam System resulting from the disposition of the Manufacturing Division.

TEST YEAR FINANCIAL STATEMENTS

Q. PLEASE DESCRIBE PETITIONER'S EXHIBIT JRB-1.

A. Petitioner's Exhibit JRB-1 is the Statement of Operations, or income statement, for the twelve months ended September 30, 2006 (the test year for this proceeding) for Citizens' Steam System. The operating income for the Steam System for the twelve months ended September 30, 2006, as shown on line 28 of Exhibit JRB-1, was $2,135,341, and the net *loss* for the Steam System, as shown on line 36 of Exhibit JRB-1, was $372,001.

Q. PLEASE DESCRIBE PETITIONER'S EXHIBIT JRB-2.

A. Petitioner's Exhibit JRB-2 is the Steam System Statement of Financial Position, or balance sheet, as of the last day of the test year, September 30, 2006. Exhibit JRB-2 also presents the cumulative balance sheet impact of Petitioner's pro forma adjustments to the test year.

The total assets of the Steam System at September 30, 2006, as shown on line 27, were $102,321,353.

It is important to note the nature of the Restricted Funds shown on lines 11 through 14 of Exhibit JRB-2. These funds are designated as *restricted* because, by the terms of the Utility's bond indentures, they are reserved for servicing long-term debt. Therefore, they are not available for use in meeting the general needs

of the Utility. The principal and interest deposit accounts accumulate funds to be paid to the bond trustee for subsequent payment to the bondholders.

The capitalization of the Steam System includes outstanding long-term debt at September 30, 2006 of $65,416,244, unamortized premium on long-term debt of $1,584,072 and retained earnings of $22,847,775. Note that retained earnings are the accumulation of the funds taken from net income and reinvested in the business over the entire span of Citizens' ownership of the Steam System. Retained earnings are not present in cash form and do not represent the accumulation of liquid assets.

Q. PLEASE DESCRIBE LINE 8 OF PETITIONER'S EXHIBIT JRB-2, STEAM CUSTOMER CONTRACTS – NET.

A. This line represents the value, net of accumulated amortization, of the contracts with customers for providing steam service that were acquired in the transaction with IPL and have continued in effect since acquisition. Generally accepted accounting principles require that the purchase price for an acquisition be allocated among the various assets acquired, including contractual rights. Citizens calculated the present value of the contracts with customers for providing steam service that were acquired in the transaction and assigned to such contracts a portion of the purchase price equal to such present value.

Q. IS THERE A BENEFIT TO STEAM CUSTOMERS OF THIS ACCOUNTING TREATMENT?

A. Yes. This accounting treatment results in the Steam System paying nearly $1 million less annually in property taxes than would be the case if the purchase price had been assigned entirely to plant assets and inventories. This is because property taxes are assessed on the value of tangible assets.

Q. WERE THE STEAM CUSTOMER CONTRACTS INCLUDED IN THE EVIDENCE THE COMMISSION CONSIDERED WHEN IT APPROVED CITIZENS' ACQUISITION OF THE STEAM SYSTEM?

A. Yes. The steam customer contracts were listed among the Acquired Assets in Section 1.01 of the Asset Purchase Agreement, which was introduced into evidence in Cause No. 41716. Section 2.01 of the Asset Purchase Agreement makes clear that the purchase price paid to IPL was for the Acquired Assets. The Order in Cause No. 41716 approving the acquisition of the Steam System from IPL stated:

> "The assets being transferred to the Board are more particularly described in Section 1.01 of the Asset Purchase Agreement submitted as Petitioner's Exhibit CBL-1 and are referred to therein as the [Steam] "System"....(Order, at page 3)
>
> The evidence shows that the transfer of the [Steam] System by IPL to the Board on the terms described in the Asset Purchase Agreement is supported by the public convenience and necessity and is in the public interest....(Order, at page 7).

Finally, the purchase price agreed to by Joint Petitioners, significantly less than the original cost depreciated value for the properties being acquired, is not excessive....(Order, at page 7).

Accordingly, the Commission finds that the proposed acquisition of the [Steam] System pursuant to the Asset Purchase Agreement set forth as Petitioner's Exhibit CBL-1 and the operation of the [Steam] System by the Board to provide steam utility service to the consumers now served by IPL will serve the public interest and should be approved." (Order, at page 7).

Q. HAVE THE AMOUNTS PRESENTED IN PETITIONER'S EXHIBITS JRB-1 AND JRB-2 BEEN SUBJECTED TO AUDIT BY AN INDEPENDENT FIRM OF CERTIFIED PUBLIC ACCOUNTANTS?

A. Yes. The amounts presented in Petitioner's Exhibit JRB-1 and the actual amounts in Petitioner's Exhibit JRB-2 are included in footnote 8 of Citizens' consolidated financial statements, which were audited by the international CPA firm of PricewaterhouseCoopers ("PwC"). The footnotes are considered an integral part of the financial statements upon which an independent auditor expresses an opinion. PwC issued an unqualified opinion on Citizens' consolidated financial statements.

Q. WHAT WAS THE TOTAL PRINCIPAL AMOUNT OF THE OUTSTANDING DEBT OF CITIZENS' STEAM SYSTEM AT SEPTEMBER 30, 2006, AS PRESENTED ON THE BALANCE SHEET IN PETITIONER'S EXHIBIT JRB-2?

A. The total principal amount of the outstanding debt of the Steam System at September 30, 2006 was $67,417,445. That amount was made up of long-term debt in the amount of $65,416,244 and current maturities of long-term debt in the amount of $2,001,201.

Q. WHEN DID CITIZENS ISSUE THIS LONG-TERM DEBT?

A. Citizens issued this long-term debt on January 15, 2001. There were actually two series of City of Indianapolis, Indiana, Thermal Energy System Revenue Bonds issued that day. One series was designated as City of Indianapolis, Indiana, Thermal Energy System Revenue Bonds, Series 2001 A, in the amount of $115,110,000. The other series was designated as City of Indianapolis, Indiana, Thermal Energy System Multi-Mode Revenue Bonds, Series 2001 B, in the amount of $48,775,000. Mr. Strohl describes the substantive terms of these two Series in his testimony.

Q. WHAT WAS THE PURPOSE FOR ISSUING THESE TWO SERIES OF BONDS?

A. The purpose for issuing these two series of bonds was to put the permanent financing in place connected with Citizens' acquisition and subsequent operation of certain assets that constitute part of the Thermal Energy System. The acquisition of assets funded by these bond issues includes the Steam System and the West Street Chilled Water operations. I use the term "permanent financing" because the acquisition of the aforementioned assets along with other necessary funding associated with the Steam System and the West Street Chilled Water

Operations was initially financed with Bond Anticipation Certificate of Indebtedness Notes ("BANs") that were issued on November 15, 2000 shortly before the acquisition transaction closed. The BANs were issued as temporary "bridge" financing until the permanent financing could be consummated. Interest earned by investors in both the BANs and the Series 2001 A and Series 2001 B bonds were and are tax-exempt. The debt amounts included in Petitioner's Exhibit JRB-2 represent only the amount of the total Thermal Energy System Revenue Bonds, Series 2001 A and Series 2001 B (collectively, "the Bonds") that was connected with financing acquisition of the assets of the Steam System, along with other necessary funding connected with the Steam System.

Q. HOW DID CITIZENS DETERMINE THE AMOUNT OF THE TOTAL THERMAL ENERGY DEBT TO APPORTION TO THE STEAM SYSTEM?

Q. This determination was made at the time the debt was issued based on the use of proceeds of the debt. A large portion of the total amount of the cash raised from the debt issues could be directly assigned to the regulated Steam System because the amount paid to IPL for the Steam System assets was separately identified in the Asset Purchase Agreement, which was introduced into evidence in Cause No. 41716. In addition, a portion of certain other funding for providing necessary working capital and for financing anticipated capital spending was separately earmarked for the Steam System and, therefore, directly assignable to the Steam System. A relatively small amount of the debt was issued to finance certain

common costs connected with the acquisition of the assets. This included legal and other professional services costs connected with the acquisition and financing of the Thermal Energy assets. The amount of debt that was incurred to fund these costs was assigned on a pro rata basis to the Steam System and West Street Chilled Water operations based on the respective proportion of the directly assignable costs. In addition, the terms of the Bond Indentures required a debt service reserve to be set aside in a restricted account as security for the Bonds. The amount of debt incurred to fund the debt service reserve account also was assigned on a pro rata basis to the Steam System and West Street Chilled Water operations based on the respective proportion of the directly assignable costs.

Q. HAVE YOU PREPARED AN EXHIBIT THAT ITEMIZES THE USE OF PROCEEDS OF THE STEAM SYSTEM PORTION OF THE TOTAL THERMAL ENERGY DEBT?

A. Yes. Petitioner's Exhibit JRB-3 provides an itemized list of the use of proceeds of the Steam System portion of the total Thermal Energy debt. Since the purpose of issuing the Bonds was to replace the BANs that had been issued as "bridge" financing, the analysis of the use of proceeds must start with an analysis of how the proceeds of the BANs were used. Petitioner's Exhibit JRB-3 shows that the Steam System portion of the BANs was used to provide $53,197,937 to fund the amount due IPL at closing for the Steam assets, as well as to fund necessary working capital of $7,000,000 and anticipated capital spending of $4,537,000 for the Steam System. In addition, a portion of the BANs also funded the Steam

System share of the professional services and other costs incurred to acquire the Thermal assets and the Steam System share of the costs incurred to issue the BANs. Consequently, the total amount of the BAN proceeds used to fund the Steam System was $65,826,178.

The percentage of the total amount of the BANs used to finance the Steam System was 43.41237%. This percentage was applied to the total amount of the Bonds to determine the Steam System portion of the Bonds and associated debt service. That is appropriate because the sole purpose for issuing the Bonds was to retire the BANs. The Bonds were issued in a larger principal amount than the BANs because, unlike the BANs which were bridge financing, the Bonds were permanent financing, which required a $12.9 million debt service reserve to be set aside in a restricted account as security for the Bonds. In addition, the principal amount of the Bonds needed to be sufficient to cover accrued interest due on the BANs at pay-off and the cost of issuing the Bonds, less the proceeds received from selling the Bonds at a premium. The net amount required for the debt service reserve, plus accrued interest on the BANs, plus the costs of issuance, less the premium received on the Bonds was $12,255,000. This was the amount by which the principal amount of the Bonds needed to exceed the outstanding amount of the BANs. Consequently, the total principal amount of the Bonds was $163,885,000. The amount of Bonds recorded on the books of the Steam System was 43.41237% of the total principal amount of the Bonds, or $71,146,364. Similarly, the amount of bond premium recorded on the books of the Steam

System was $2,278,514, the amount of bond issuance expenses was $1,330,821, the amount of the reserve fund was $5,614,221, and the amount of accrued interest on the BANs was $653,658. The net of the Steam System share of the principal amount of the bonds, plus its share of the bond premium, less its share of the issuance expenses, the reserve fund and accrued interest was $65,826,178, or exactly the amount required to pay off the Steam System share of the BANs.

Q. THE AMOUNT OF THE DEBT SERVICE RESERVE FUND SHOWN ON THE SEPTEMBER 30, 2006 BALANCE SHEET ON PETITIONER'S EXHIBIT JRB-2, LINE 11, IS QUITE SMALL COMPARED TO THE ORIGINAL DEBT SERVICE RESERVE FUNDING SHOWN ON PETITIONER'S EXHIBIT JRB-3. WHAT HAPPENED TO THAT DEBT SERVICE RESERVE?

A. During the test year, Petitioner determined that it was cost effective to replace the debt service reserve through the purchase of a surety bond. Upon consummation of that transaction, the Trustee lifted the restriction on the cash on deposit in the Bond Reserve Fund. Citizens then transferred that cash to a construction fund for the purpose of financing a portion of the MACT environmental compliance project at the Perry K steam plant. At September 30, 2006, $3,177,627 remained in the construction fund.

Q. WHAT IS THE TOTAL ANNUAL DEBT SERVICE ON THE DEBT THAT FINANCED THE STEAM SYSTEM?

A. The actual debt service on the Steam System debt for the test year was $5,193,874. The pro forma debt service on such debt is $5,267,722. The test year and pro forma debt service amounts are explained in detail by Petitioner's witness Michael D. Strohl in his direct testimony.

Q. WAS THE ESTIMATED AMOUNT OF DEBT SERVICE THAT WAS ANTICIPATED TO BE PART OF THE REVENUE REQUIREMENTS OF THE STEAM SYSTEM ADDRESSED IN A PRIOR PROCEEDING?

A. Yes. The Commission's October 4, 2000 Order in Cause No. 41716, which approved the acquisition of the Steam System from IPL, stated:

> "Mr. Lykins testified that IPL's current rates and charges would produce sufficient revenue to allow the Board to meet its statutory revenue requirements to provide steam service, including the estimated debt service requirements associated with its intended financing. . .
>
> Annual debt service requirements associated with the Board's contemplated steam debt structure is currently estimated to be approximately $5,473,226." (Order in Cause No. 41716, at page 5).

The $5,267,722 pro forma debt service requirement of the Steam System is some $205,504 *less* than the amount of debt service Citizens anticipated when the Commission approved Citizens acquisition of the Steam System from IPL.

Q. HAVE YOU CALCULATED THE DEBT SERVICE COVERAGE RATIO FOR THE STEAM SYSTEM ON A "STAND-ALONE" BASIS?

A. Yes. Although the Thermal Energy debt, including the Steam System portion, is secured by a pledge of the revenues of the total Thermal System, it is important and fair that the Steam System shoulder its share of that responsibility. Petitioner's Exhibit JRB-4 is a computation of the Steam System's stand-alone debt service coverage ratio on a pro forma basis at present rates and at the proposed rates and charges for steam service requested in this case. Petitioner's Exhibit JRB-4 shows at present rates the debt service coverage ratio for the Steam System on a stand-alone basis is less than 1.0, specifically it is 0.44. This means at present rates the Steam System can pay less than half of the service on its share of the total Thermal Energy debt, *assuming it makes no expenditures for extensions and replacements.* If funds for extensions and replacements are taken into consideration, at present rates the Steam System cannot pay any amount toward its share of the total Thermal Energy debt service, in fact the funds available for debt service are negative. Petitioner's Exhibit JRB-4 also shows the rates and charges for steam service proposed in this case will allow the Steam System to achieve a stand-alone debt service coverage ratio of 1.70, a level that is reasonable, in my opinion.

Q. PLEASE EXPLAIN THE PRO FORMA ADJUSTMENTS THAT APPEAR ON PETITIONER'S EXHIBIT JRB-2.

A. The purpose of the pro forma adjustments on Petitioner's Exhibit JRB-2 is to properly reflect those fixed, known and measurable items that affect the amount of cash Petitioner will have when the rates and charges for steam service

approved in this case are placed in effect. It is necessary to adjust the cash balance in this way in order to properly compute the annual interest income that Petitioner actually will earn when the rates and charges sought in this case are implemented. The adjustments appearing on Exhibit JRB-2, page 1, are identified by reference number and explained in detail on Exhibit JRB-2, page 2.

Adjustment 1 reflects the remaining amount to be spent on the MACT compliance project. The Prehearing Conference Order in this case established a cut-off date for used and useful property as of September 30, 2007, which enabled Petitioner to reflect the required expenditures on the MACT compliance project as an adjustment to the test year. The testimony of Petitioner's witness Jamie Dillard shows that the total estimated cost of the MACT compliance project is $14,000,000. Through the end of the test year $4,900,349 of that total estimate had been spent on the project. That means an additional $9,099,651 will be spent to complete the MACT compliance project. Of that amount, $3,177,627 will be funded from the amount remaining in the construction fund. The remaining balance of $5,922,024 will be funded from available cash. As of February 28, 2007, the amount remaining in the construction fund was zero.

Adjustment 2 simply reflects the transfer of the total cost of the MACT compliance project from Construction Work in Progress to Utility Plant in Service upon completion of the project, which will occur prior to September 30, 2007. Adjustment 2 does not affect cash.

Adjustment 3 reflects the cash impact of the inherent lag between the end of the test year and the actual receipt of an Order in this case authorizing an increase in rates and charges for steam service. Petitioner's witness Prentice shows the total pro forma annual cash revenue shortfall of Petitioner is ($6,659,432). The time schedule established by the Prehearing Conference Order in this case demonstrates that an Order is not likely to be received prior to October, 2007. Consequently, Petitioner will have to draw down its available cash to fund the cash deficit that will occur while this case is pending before the Commission.

Adjustment 3 charges Retained Earnings with the pro forma net loss per books of Petitioner. Adjustment 3 also reflects the other pro forma items in the cash revenue requirements methodology that impact the balance sheet, in addition to the net loss per books. This adjustment is necessary to properly reflect the impact of the pro forma cash revenue requirement deficit on cash. Consequently, Adjustment 3 charges the pro forma amount of Extensions and Replacements to Utility Plant in Service and credits the pro forma amount of depreciation and amortization expense to Accumulated Depreciation and Steam Customer Contracts - Net. Adjustment 3 also charges Long-Term Debt with the portion of total pro forma debt service required for principal payments on such debt. No adjustment is necessary to reflect the interest portion of total debt service as that amount is included in the net loss per books that was charged to Retained

Earnings. The resulting credit to available cash of all these adjustments equals the cash revenue requirement deficit.

The resulting pro forma cash balance of all the aforementioned adjustments, shown in the last column on Exhibit JRB-2, page 1, line 15, is $2,015,529. This is the amount Petitioner's witness Michael D. Strohl used to compute pro forma interest income.

CORPORATE SUPPORT SERVICES

Q. TURNING TO A NEW SUBJECT, WHAT IS CORPORATE SUPPORT SERVICES?

A. Citizens has organized its executive management and administrative functions as well as certain billing and customer service functions within a centralized Corporate Support Services or "CSS" organizational framework. This centralized organizational framework includes the following departments: Executive, Finance, Treasury, Human Resources, Legal, Corporate Affairs, Risk Management, Internal Audit, Regulatory Affairs, Marketing, Security, Billing, Customer Relations, Information Services, Environmental Affairs, Safety, Procurement and Building Maintenance. By centralizing these functions, Citizens is able to combine and share its executive management and administrative capabilities across the various business units that are served by and benefit from the activities of the CSS personnel.

Q. HOW ARE CSS COSTS ASSIGNED TO THE VARIOUS BUSINESS UNITS THAT ARE SERVED BY AND BENEFIT FROM THE ACTIVITIES OF THE CSS PERSONNEL?

A. Citizens utilizes a sophisticated activity-based cost allocation methodology to assign CSS costs to the ultimate cost causer or consumer of a particular service. The allocation of CSS costs is accomplished through a detailed cost model with numerous cost drivers. The costs incurred by the CSS departments are initially collected by function, or service performed, using direct assignments or percent of time estimates by departmental subject matter experts. Once all the costs of a function or service have been collected, the total cost of that function or service is assigned to the various business units that consume that service. Costs of each function or service are assigned to the consuming business unit based on a cost driver that best explains how the particular service in question is consumed.

For example, the costs associated with providing payroll processing (including labor, benefits, supplies, information system support, etc.) are assigned to the various users of the payroll processing service based upon the number of paychecks processed for the various divisions. In the same manner, costs associated with the customer call center of Citizens Gas & Coke Utility ("Citizens Gas") are assigned to the Gas Division and Citizens Gas of Westfield based on the number of customer calls.

Other examples of services and cost drivers include:

Service Performed	Cost Driver
PC Support	# of workstations
Benefit administration	# of active & retired employees
Pay vendors	# of invoice transactions
Bill customers	# of customer bills
Executive support	Time studies
Facility costs	# of square feet used
Remittance processing	Direct assignment
Staffing services	# of projected new hires

The objective of the cost allocation methodology is to assign the costs of CSS services as accurately as possible to the consumers or beneficiaries of each service.

Q. ARE THERE CERTAIN CSS COSTS THAT CANNOT BE DIRECTLY ASSIGNED TO THE CONSUMERS OR BENEFICIARIES OF THE SERVICE BASED ON A COST DRIVER?

A. Yes. Certain CSS costs are overall entity costs incurred to support the consolidated charitable trust enterprise. Such costs are incurred because the Board of Directors has continuing beneficiary interests to satisfy and a purpose to fulfill in terms of its obligations to govern, manage, operate, regulate and control the Gas Division, the Steam System, and other assets held in trust. These CSS costs are classified as "Trust Administration" costs.

Q. ARE ALL ADMINISTRATIVE COSTS OF THE TRUST CHARGED TO TRUST ADMINISTRATION?

A. No. Let me provide an example of how administrative costs are distinguished between costs that are charged to a particular business unit and costs that are

charged to Trust Administration. My time allocation provides a good illustration. When I am working directly with any particular business unit of the Trust to provide financial expertise, planning and support to that unit, my time is charged directly to the unit. However, when I am engaged in strategic planning and administrative activities to assure that all activities of the Trust remain aligned toward the ultimate purpose of providing the right mix of short-term and long-term benefits to the Trust on behalf of its beneficiaries, my time is charged to Trust Administration. The following table illustrates the allocation of my time during the test year:

Business Unit	Time Allocation %
CBP	15%
Gas Division	40%
Manufacturing	5%
Steam	5%
Chilled Water	5%
Trust Administration	30%

As the above example illustrates, Trust Administration costs are only a subset of total CSS charges.

Q. **WHAT IS THE RATIO OF TRUST ADMINISTRATION COSTS TO THE TOTAL OF ALL CSS CHARGES?**

A. During the test year, the total amount of CSS costs incurred on behalf of the entire Trust was $46,158,480. Of that amount, $8,092,109 was for Trust Administration.

Q. CAN YOU PROVIDE SOME EXAMPLES OF TRUST ADMINISTRATION COSTS?

A. Yes. In addition to executive administration of Trust matters and certain strategic planning activities as illustrated above in the example of my time, other examples of Trust Administration costs include fiduciary insurance, director and officer liability insurance, statutory fees paid to members of the Board of Directors and Board of Trustees, preparation of Trust-level financial reports, external audit fees and general Trust governmental and other external relations not specifically related to a particular business unit.

Q. HOW ARE TRUST ADMINISTRATION COSTS ALLOCATED TO THE VARIOUS BUSINESS UNITS?

A. Trust Administration costs are allocated to business units based on the respective business unit's percentage of prior year revenues to total Trust prior year revenues. This is the allocation methodology Ordered by the Commission in its finding on this subject in the last Citizens Gas rate case, Cause No. 42767, at page 44. Citizens Gas received this Order prior to finalizing the closing of its books for fiscal year 2006, which is the test year in this case. Citizens adjusted its actual fiscal year 2006 books before the final closing of such books to comply with the allocation methodology for Trust Administration costs indicated in the

Commission's Order. Consequently, the test year actual financial statements reflect the allocation methodology indicated on page 44 of the Order.

Q. PLEASE EXPLAIN PETITIONER'S EXHIBIT JRB-5.

A. Petitioner's Exhibit JRB-5 computes the pro forma adjustment to the test year allocation of CSS costs to all business units of the Trust resulting from the disposition of the Manufacturing Division. Mr. Lykins explains this matter in more detail in his testimony. This pro forma adjustment is necessary because disposition of the Manufacturing Division is a fixed, known and measurable event and it has a fixed, known and measurable impact on both the total amount of CSS costs and on the allocation of those costs to business units such as the Steam System.

As I explained above, the vast majority of CSS costs are allocated to business units based on cost drivers that best explain how each particular CSS service is consumed. In addition, the subset of total CSS costs known as Trust Administration costs are allocated to business units based on the respective business unit's percentage of prior year revenues to total Trust prior year revenues. Petitioner's Exhibit JRB-5 first adjusts total Trust-wide CSS costs for the anticipated reduction in such costs that will result from the disposition of the Manufacturing Division, and then reallocates the resulting CSS total to the various business units based on the revised cost driver and percentage of revenue allocation factors that ensue from eliminating the Manufacturing Division as part of the Trust.

Line 15 of Petitioner's Exhibit JRB-5 shows the total pro forma reduction in CSS costs resulting from the disposition of the Manufacturing Division is $3,401,903. Line 16 of Petitioner's Exhibit JRB-5 shows the pro forma total amount of CSS costs that remain after the disposition of the Manufacturing Division is $42,756,577.

Column B, lines 17 through 29 of Petitioner's Exhibit JRB-5 shows the reallocation of the pro forma CSS costs to the respective business units as well as to Trust Administration based on the revised cost drivers that remain. Column D, lines 17 through 29 of Petitioner's Exhibit JRB-5 shows the reallocation of the pro forma Trust Administration costs to the respective business units based on the test year proportion of revenue of each Division to total Trust revenue excluding the revenue of the Manufacturing Division.

Q. WHAT IS THE REASON THE ENTIRE AMOUNT OF CSS COSTS ALLOCATED TO THE MANUFACTURING DIVISION DURING THE TEST YEAR IS NOT ELIMINATED FROM TOTAL CSS COSTS UPON DISPOSITION OF THE MANUFACTURING DIVISION?

A. CSS costs are not true variable costs. They do not rise and fall in direct proportion to increases or decreases in the cost drivers that best allocate such costs. For example, during the test year 5% my time was dedicated to directly supporting the Manufacturing Division and another 6.7% of my time was charged to the Manufacturing Division through the allocation of Trust Administration

costs.[1] This means a total of 11.7% of my time was allocated to the Manufacturing Division. However, following the disposition of the Manufacturing Division the Trust will continue to need a CFO, so a proportionally higher percentage of my time will be spent directly supporting other Divisions, including the Steam System. In addition, the portion of my time that is spent on Trust Administration matters will be allocated in greater proportion to the remaining Divisions, including the Steam System, based on the proportion of revenue of each Division to total Trust revenue excluding the revenue of the Manufacturing Division.

Another example of a CSS cost that does not increase or decrease in direct proportion to the change in the cost driver that allocates the cost is the cost of preparing our Annual Report. The length of the Annual Report and the information it must contain will not materially change when the Manufacturing Division is no longer part of the Trust. Although 22.4% of the cost of preparing the Annual Report was charged to the Manufacturing Division during the test year through the allocation of Trust Administration costs, the total cost the Trust will incur to prepare the Annual Report will not change as a result of the disposition of the Manufacturing Division. This means each remaining Division will be charged a larger proportionate share of the cost of the Annual Report based on the

[1] 30% of my time is charged to Trust Administration and 22.4% of Trust Administration is charged to the Manufacturing Division as the proportion of Manufacturing Division revenue to total Trust revenue is 22.4%. Consequently, 30% x 22.4% = 6.7%.

proportion of revenue of each Division to total Trust revenue excluding the revenue of the Manufacturing Division.

The above examples of my time and the cost of the Annual Report are not an exhaustive list of CSS costs that do not materially change because of the disposition of the Manufacturing Division. They are merely representative examples to help explain why the entire amount of CSS costs allocated to the Manufacturing Division during the test year do not go away upon the disposition of the Manufacturing Division. Determining the amount of CSS costs that are affected by the disposition of the Manufacturing Division requires a detailed study.

Q. HAS SUCH A DETAILED STUDY BEEN CONDUCTED?

A. Yes. A team that includes all officers and department heads overseeing areas engaged in CSS activities analyzed the impact of the disposition of the Manufacturing Division on CSS activities and identified the activities that would be reduced by the elimination of the Manufacturing Division from the Trust. The team accomplished this by identifying the CSS departments that provide services to the Manufacturing Division, or that charge time to Trust Administration, and then performed a line-by-line review of all labor and other costs incurred by such departments. The purpose of the line-by-line review was to identify the costs that could be reduced or eliminated upon the elimination of the Manufacturing Division from the Trust.

One major activity of the team involved analyzing the amount of CSS full-time equivalent employees that were allocated to the Manufacturing Division. Petitioner's Exhibit JRB-6, Column A shows a full-time equivalent of 18.37 CSS employees allocated time directly to the Manufacturing Division during the test year. Petitioner's Exhibit JRB-6, Column C, shows an additional 7.24 full-time equivalent CSS employees indirectly allocated time to the Manufacturing Division through the allocation of Trust Administration costs. This amounts to a total full-time equivalent of 25.61 CSS employees that allocated time to the Manufacturing Division during the test year, as shown on Petitioner's Exhibit JRB-6, Column D. The team determined of that amount, 19 CSS positions could be reduced upon the elimination of the Manufacturing Division from the Trust. The following summarizes why certain CSS departments could not achieve a one-for-one reduction of positions, as compared to full-time equivalent allocations:

- The Executive FTE allocation includes 4 executives and 3 assistants that allocated part of their time to the Manufacturing Division and Trust Administration during the test year. These positions oversee a broad spectrum of Trust activities and will continue to be needed following the disposition of the Manufacturing Division.
- The Procurement FTE allocation includes the time of the Director of Purchasing that was allocated to Trust Administration during the test year. This position oversees all procurement activities of the Trust and will continue to be needed.

- The Finance FTE allocation includes several accounting personnel that allocate to Trust Administration the portion of their time spent on Trust-wide accounting matters such as budget coordination, oversight of the monthly closing process, accounting for CSS costs, external financial reporting, support of the accounting system, bank reconciliations and oversight of the accounting organization. Such Trust-wide accounting work, in large measure, is unaffected by the disposition of the Manufacturing Division.
- The Treasury FTE allocation includes the time of the Treasurer and the cash manager that allocate time to Trust Administration. These positions oversee all of the financing, short-term borrowing and short-term cash investing activities of the Trust and will continue to be needed following the disposition of the Manufacturing Division.
- The Risk Management FTE allocation includes time allocated to Trust Administration for a portion of the time of the Director of Risk Management, the Manager of Insurance, and two people that coordinate the internal control compliance activities of the Trust. These positions impact broad areas of the Trust and will continue to be needed.
- The Human Resources FTE allocation includes two people that support the Trust's quality culture and charge their time to Trust Administration. These positions impact broad areas of the Trust and will continue to be needed following the disposition of the Manufacturing Division.

- The Corporate Affairs FTE allocation includes several people that allocate to Trust Administration a portion of their time spent on Trust-wide matters such as media relations, the Trust internal newspaper, layout of the Annual Report and oversight of its preparation and publication, administration of community support activities and website layout and administration. Such Trust-wide activities will not be reduced materially following disposition of the Manufacturing Division.
- The Environmental Affairs FTE allocation includes one person that divides his time equally between supporting the environmental compliance activities of the Manufacturing Division and supporting all other environmental compliance activities of the Trust. This position will continue to be fully needed for several years, as environmental compliance requirements will extend for a number of years.
- The Legal FTE allocation assumes it is more cost effective to retain the entire in-house legal staff following the disposition of the Manufacturing Division and use the time gained from the elimination of Manufacturing Division activities to reduce outside legal fees.
- The General Office Security FTE allocation is for the security guards covering various doors at Citizens' general office. The time of such guards is allocated to all Divisions, including the Manufacturing Division, based on the proportionate allocation of all CSS wages to the various

Divisions of the Trust. However, the need for the security guards at the general office facility will continue for so long as that Building is in use.

Q. DID THE TEAM CONDUCT A SIMILAR LINE-BY-LINE REVIEW OF CSS NON-LABOR COSTS TO ASSESS THE IMPACT OF THE SALE OF THE MANUFACTURING DIVISION ON SUCH COSTS?

A. Yes. Petitioner's Exhibit JRB-7 shows each CSS department's non-labor costs that were directly allocated to the Manufacturing Division during the test year as well as each line item of such costs that were indirectly allocated to the Manufacturing Division through the allocation of Trust Administration costs. Petitioner's Exhibit JRB-7, Column D shows the total amount of CSS non-labor costs allocated to the Manufacturing Division during the test year was $1,944,547. The team determined of that amount, $1,236,847 could be reduced upon the elimination of the Manufacturing Division from the Trust as shown in Column E of Petitioner's Exhibit JRB-7. The following summarizes why certain CSS departments cannot reduce CSS non-labor costs by the amount such costs were allocated to the Manufacturing Division during the test year:

- The Executive allocation of CSS costs to the Manufacturing Division includes Director's fees, company membership fees and dues in trade and technical associations, and other Trust Administration expenses that are not impacted by the elimination of the Manufacturing Division from the Trust.

- The Procurement allocation of CSS costs to the Manufacturing Division includes general departmental Trust Administration costs that are not impacted by the elimination of the Manufacturing Division from the Trust.
- The Finance allocation of CSS costs to the Manufacturing Division includes general departmental Trust Administration and other costs that are not impacted by the elimination of the Manufacturing Division from the Trust.
- The Risk Management allocation of CSS costs to the Manufacturing Division includes general departmental costs that are not impacted by the elimination of the Manufacturing Division from the Trust.
- The Internal Audit allocation of CSS costs to the Manufacturing Division includes internal controls consulting services and other costs charged to Trust Administration that are not impacted by the elimination of the Manufacturing Division from the Trust.
- The Human Resources allocation of CSS costs to the Manufacturing Division was a fixed allocation factor based on the ratio of Manufacturing Division employees to total Trust employees. However, a substantial portion of Human Resources non-labor costs are incurred for matters that are not proportionally impacted by the elimination of the Manufacturing Division from the Trust such as professional and leadership training, compensation surveys, support of the Trust's quality culture, and general administrative matters.

- The Information Services allocation of non-labor costs to the Manufacturing Division was based on the criteria used to allocate Information Services labor costs to the Manufacturing Division. However, the non-labor costs of the Information Services department are incurred largely for matters that are not impacted by the elimination of the Manufacturing Division such as maintenance of Trust-wide application systems including accounting, payroll, human resources, purchasing and inventory; networking; system security and business continuity planning; and telephony.
- The Corporate Affairs allocation of non-labor costs to the Manufacturing Division was based on the criteria used to allocate Corporate Affairs labor costs to the Manufacturing Division. However, a substantial portion of Corporate Affairs non-labor costs are incurred for activities and programs that are not proportionally impacted by the elimination of the Manufacturing Division from the Trust.
- The Environmental Affairs allocation of non-labor costs to the Manufacturing Division was based on historical experience with respect to the percentage of non-labor costs that were incurred on behalf of the Manufacturing Division. However, during the test year $8,711 of non-labor cost was incurred by the Environmental Affairs department specifically on behalf of the Manufacturing Division.

- As described in the answer to the previous question, the Trust plans to retain its entire in-house legal staff upon the elimination of the Manufacturing Division. Consequently, the non-labor costs of the Legal department will not be impacted. As stated above, the in-house legal staff will use the time gained from the elimination of Manufacturing Division activities to reduce outside legal fees.
- Certain costs incurred with respect to Citizens' general office facility are allocated to the Manufacturing Division because certain employees providing executive oversight and administrative support to the Manufacturing Division work in the general office facility. However, the costs that Citizens incurs with respect to its general office facility are unaffected by the elimination of the Manufacturing Division from the Trust. This includes general office security, maintenance, depreciation and property taxes.
- During the test year, 22.4% of the cost of Corporate Insurance for Directors and Officers liability, fiduciary liability and the general office was allocated to the Manufacturing Division through the allocation of Trust Administration costs. However, such insurance costs are largely unaffected by the elimination of the Manufacturing Division from the Trust.

Q. PLEASE DESCRIBE THE REDUCTIONS IN OUTSIDE PROFESSIONAL SERVICES COSTS SHOWN IN COLUMN E, LINE 19 OF PETITIONER'S EXHIBIT JRB-7.

A. The Legal department conducted a review of outside legal costs that were incurred during the test year to determine the amount of those costs that were incurred on behalf of the Manufacturing Division. The review determined that $1,006,781 of outside legal costs were attributable to situations unique to the Manufacturing Division during the test year. Even though the percentage of outside legal costs incurred on behalf on the Manufacturing Division, as compared to other Divisions, was higher than normal during the test year, we believe this amount is a good proxy for the ongoing level of outside legal cost savings the Trust can experience if it retains the in-house legal staff following the elimination of the Manufacturing Division from the Trust.

The other major component of outside professional service fees is the cost of the annual financial audit. This cost is largely unaffected by the elimination of the Manufacturing Division from the Trust.

Q. PLEASE DESCRIBE PETITIONER'S EXHIBIT JRB-8.

A. Petitioner's Exhibit JRB-8 summarizes the impact to the Steam System of the pro forma adjustment to the test year allocation of CSS costs that result from the elimination of the Manufacturing Division from the Trust. The amounts on Petitioner's Exhibit JRB-8 serve as inputs to the pro forma adjustments that Mrs. Prentice makes with respect to CSS costs.

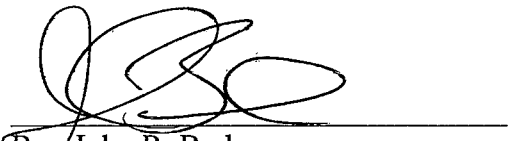
Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, at this time.

VERIFICATION

STATE OF INDIANA)
) ss:
COUNTY OF MARION)

The undersigned, John R. Brehm, under penalties of perjury and being first duly sworn on his oath, says that he is Senior Vice President and Chief Financial Officer for Citizens Thermal Energy; that he caused to be prepared and read the foregoing Direct Testimony; and that the representations set forth therein are true and correct to the best of his knowledge, information and belief.



By: John R. Brehm
Senior Vice President and Chief Financial Officer
Citizens Thermal Energy

Subscribed and sworn to before me, a Notary Public, this 30th day of March, 2007.

Valorie L. Dalton
Signature

Valorie L. Dalton
Printed Name

My Commission Expires: 2/11/09

My County of Residence: Marion

Steam System
Statement of Operations
12 Months Ended September 30, 2006

Line No.		
	Operating Revenues:	
1	Steam Revenues	49,746,392
2	Electric Revenues	6,538
3	Total Operating Revenues	49,752,930
	Operating Expenses:	
	Cost of Goods Sold:	
4	Coal, Oil & Gas	15,384,565
5	Steam & Electric	12,985,053
6	Water & Sewer	178,255
7	Chemicals	420,874
8	Total Cost of Goods Sold	28,968,747
	Operations & Maintenance:	
9	Plant Operations	2,565,034
10	Plant Maintenance	3,575,981
11	Distribution Maintenance	2,533,394
12	Customer Operations & Metering	323,817
13	Total Operations & Maintenance	8,998,226
	General & Administrative:	
14	G & A Salaries	1,184,994
15	Outside Services	271,622
16	Employee Benefits	1,893,237
17	Corporate Support Services	2,690,605
18	Other G & A	406,310
19	Total General & Administrative	6,446,768
	Depreciation & Amortization:	
20	Depreciation	1,502,222
21	Amortization	187,152
22	Total Depreciation & Amortization	1,689,374
	Taxes:	
23	Property	438,831
24	Payroll	406,790
25	Indiana Gross Income	668,853
26	Total Taxes	1,514,474
27	Total Operating Expenses	47,617,589
28	Total Operating Income	2,135,341
	Other Income (Expense) - Net:	
29	Interest Income	621,040
30	Miscellaneous Income Deductions	(55,237)
31	Total Other Income (Expense) - Net	565,803
	Interest Charges:	
32	Interest on Long-Term Debt	3,122,302
33	Amortization of Debt Premium and Expense	(21,384)
34	Interest Charged to Construction - Credit	(27,773)
35	Total Interest Charges	3,073,145
36	Net Income	(372,001)

Steam System
Statement of Financial Position

Line No		At 30-Sep-06	Pro Forma Adjustments Dr.	CR.	Ref.	Pro Forma
	Assets					
	Utility Plant:					
1	Utility Plant in Service	31,489,748	14,000,000		2	49,336,345
2			3,846,597		3	
3	Accumulated Depreciation	(3,598,528)		(2,255,825)	3	(5,854,353)
4	Net Plant in Service	27,891,220				43,481,992
5	Construction Work in Progress	7,959,954	9,099,651		1	3,059,605
6				(14,000,000)	2	
7	Net Utility Plant	35,851,174				46,541,597
	Intangibles:					
8	Steam Customer Contracts - Net	31,854,803		(187,152)	3	31,667,651
9	Intangible Pension Asset	283,465				283,465
10	Total Intangibles	32,138,268				31,951,116
	Investments:					
11	Bond Reserve Fund	1,307				1,307
12	Bond Retirement Fund	-				-
13	Bond Interest Deposit Funds	3,257,903				3,257,903
14	Total Investments	3,259,210				3,259,210
	Current Assets:					
15	Cash and Cash Equivalents	14,596,985		(5,922,024)	1	2,015,529
16				(6,659,432)	3	
17	Construction Fund	3,177,627		(3,177,627)	1	-
18	Accounts Receivable - Net	3,908,913				3,908,913
19	Recoverable Fuel Costs	4,483,561				4,483,561
20	Materials and Supplies, at Average Cost	4,191,781				4,191,781
21	Prepayments and Deposits	320,469				320,469
22	Total Current Assets	30,679,336				14,920,253
	Deferred Charges:					
23	Bond Issuance Costs - Net	1,180,518				1,180,518
24	Prepaid Retirement Benefit Costs	(852,500)				(852,500)
25	Other Deferred Charges	65,347				65,347
26	Total Deferred Charges	393,365				393,365
27	Total Assets	102,321,353	26,946,248	(32,202,060)		97,065,541
	Capitalization and Liabilities					
	Capitalization:					
28	Retained Earnings and Accumulated OCI	22,847,775	3,178,643		3	19,669,132
29	Long-Term Debt	65,416,244	2,077,169		3	63,339,075
30	Unamortized Premium on Long Term Debt	1,584,072				1,584,072
31	Total Capitalization	89,848,091				84,592,279
	Current Liabilities:					
32	Current Maturities of Long-Term Debt	2,001,201				2,001,201
33	Accounts Payable and Accrued Expenses	9,807,493				9,807,493
34	Accrued Taxes	664,568				664,568
35	Total Current Liabilities	12,473,262				12,473,262
36	Total Capitalization and Liabilities	102,321,353	5,255,812	-		97,065,541
37			32,202,060	(32,202,060)		

Steam System
Statement of Financial Position
Explanation of Pro Forma Adjustments

		Dr.	Cr.
Reference # 1			
	To record remaining expenditures on MACT project:		
	Construction Work in Progress	9,099,651	
	Construction Fund		3,177,627
	Cash		5,922,024
Reference # 2			
	To close MACT project to Utility Plant in Service:		
	Utility Plant in Service	14,000,000	
	Construction Work in Progress		14,000,000
Reference # 3			
	To recognize balance sheet impact of regulatory lag:		
	Utility Plant in Service (To record E&R)	3,846,597	
	Retained Earnings (To record net loss per books)	3,178,643	
	Long-Term Debt (To record principal payment)	2,077,169	
	Accumulated Depreciation (To record depreciation expense)		2,255,825
	Accumulated Amortization (To record amortization expense)		187,152
	Cash (To record cash deficit)		6,659,432

Steam System
Statement of Use of Debt Proceeds
Upon Issuance of BAN's on 11/15/00 and Subsequent Issuance of
2001 A and B Series on 1/15/01

BANs:		
Steam Asset Purchase Price		54,650,000
Less:		
Assumption of Property Tax Liability	(1,010,156)	
Escrow Deposit	(425,000)	
Escrow Interest	(16,907)	
Total Purchase Adjustments		(1,452,063)
Amount Due Seller at Closing for Steam Assets		53,197,937
Add:		
Working Capital Funding		7,000,000
Capital Expenditure Funding		4,537,000
Steam Share of Acquisition Expenses		960,887
Steam Share of BAN Issuance Costs		130,354
Total Steam Portion of BANs		65,826,178
Total Amount of BANs		151,630,000
Steam Share of BANs		43.41237%

Thermal Energy System Revenue Bonds:	**Total**	**Steam Share**
Amount Required to Pay Off BANs	151,630,000	65,826,178
Accrued Interest Due on BANs at Pay-Off	1,505,696	653,658
Amount Required to Fund Reserve Fund	12,932,306	5,614,221
Amount Required to Cover Cost of Issuance	3,065,535	1,330,821
Less: Premium on Bonds	(5,248,537)	(2,278,514)
Total Principal Amount of Bonds	163,885,000	71,146,364
Principal Amount of 2001 A Series	115,110,000	49,971,980
Principal Amount of 2001 B Series	48,775,000	21,174,384
Total	163,885,000	71,146,364

Steam System
Pro Forma Debt Service Coverage Ratio

	Present Rates	Proposed Rates
Pro Forma Operating Income	(137,744)	6,521,688
Depreciation and Amortization Expense	2,442,977	2,442,977
Earnings Before Interest, Depreciation and Amortization	2,305,233	8,964,665
Pro Forma Debt Service	5,267,722	5,267,722
Pro Forma Debt Service Coverage Ratio	0.44	1.70

Proforma Adjustment to CSS Allocations for Disposition of Manufacturing Division

CSS Cost Allocations **including** Manufacturing Division

	A	B	C	D	E
			Trust Administration		Total CSS
	Business Unit	Total CSS $	Alloc % (a)	Alloc $$	Allocations
1	Gas Division	26,815,113	63.4%	5,130,397	31,945,510
2	Manufacturing Div	3,500,054	22.4%	1,812,632	5,312,686
3	Oil Division	33,915	0.7%	56,645	90,560
4	Steam Division	2,067,513	7.7%	623,092	2,690,605
5	WSCW Division	801,514	3.5%	283,224	1,084,738
6	Ice Division	160,912	1.0%	80,921	241,833
7	Lilly Corp Center	79,867	0.1%	8,092	87,959
8	Lilly Greenfield	68,291	0.1%	8,092	76,383
9	Credit Union	24,744			24,744
10	Westfield Gas	105,323			105,323
11	CBP/Affiliates	1,065,686	1.1%	89,014	1,154,700
12	Non-operating (below-the-line)	3,343,439			3,343,439
13	Trust Administration	8,092,109	-100.0%	(8,092,109)	-
14	Total CSS Costs	46,158,480	0.00%	-	46,158,480
15	Proforma Reduction in CSS costs after disposition of Manufacturing	(3,401,903)			
16	Revised CSS Costs	42,756,577			

⇩

CSS Cost Allocations **excluding** Manufacturing Division

			(b)		
17	Gas Division	27,995,722	81.9%	5,410,797	33,406,519
18	Manufacturing Div	-	0.0%	-	-
19	Oil Division	35,317	1.0%	66,066	101,383
20	Steam Division	2,252,076	9.8%	647,446	2,899,522
21	WSCW Division	864,420	4.3%	284,083	1,148,503
22	Ice Division	174,423	1.2%	79,279	253,702
23	Lilly Corp Center	108,957	0.1%	6,607	115,564
24	Lilly Greenfield	89,122	0.1%	6,607	95,729
25	Credit Union	28,444		-	28,444
26	Westfield Gas	109,805		-	109,805
27	CBP/Affiliates	1,148,262	1.6%	105,705	1,253,967
28	Non-operating (below-the-line)	3,343,439		-	3,343,439
29	Trust Administration	6,606,590	-100.0%	(6,606,590)	
30	Total CSS Costs	42,756,577	0.00%	-	42,756,577

note (a) - Trust administration costs are allocated based upon FY2005 % of total revenue including Manufacturing Division

note (b) - Trust administration costs are allocated based upon FY2006 % of total revenue excluding Manufacturing Division

Impact of Disposition of Manufacturing Division on CSS Full-Time Equivalent Employees FY2006

	Department	A CSS FTE Allocated to Mfg Div	B CSS FTE Allocated to Trust Admin	C 22.4% Trust Admin FTE to Mfg Div [B x 22.4%]	D Total CSS FTE Allocated to Mfg Div [A + C]	E Planned Reductions in CSS FTE re Mfg
1	Executive	0.45	4.42	0.99	1.44	(1.00)
2	Safety	1.04	2.00	0.45	1.49	(2.00)
3	Procurement	1.00	1.00	0.22	1.22	(1.00)
4	Finance	3.06	9.34	2.09	5.15	(4.00)
5	Treasury	1.19	1.47	0.33	1.52	(1.00)
6	Risk Mgmt	1.20	1.48	0.33	1.53	(1.00)
7	Int Audit	-	5.00	1.12	1.12	(1.00)
8	Human Resources	5.04	2.00	0.45	5.49	(5.00)
9	Info Services	2.57	2.13	0.48	3.05	(3.00)
10	Corp Affairs	0.78	2.44	0.55	1.33	-
11	Env Affairs	0.50	-	0	0.50	-
12	Legal	1.17	-	0	1.17	-
13	G.O. Security	0.37	1.01	0.23	0.60	-
14	Cust Svcs	-	-	0	-	-
15	Rates	-	-	0	-	-
16	Marketing	-	-	0	-	-
17	"Treasury" CBP	-	-	0	-	-
18	Total	18.37	32.29	7.24	25.61	(19.00)

note: column A represents FTE's allocated specifically to Mfg division via cost drivers like # employees, # invoices, % of time estimates, # of PC's, # paychecks, etc.

Petitioner's Exhibit JRB-7
IURC Cause No. 43201

Impact of Disposition of Manufacturing Division on CSS NonLabor FY2006

	Department	A CSS NonLabor Allocated to Mfg Div	B CSS NonLabor Allocated to Trust Admin	C 22.4% Trust Admin FTE to Mfg Div [B x C]	D Total CSS NonLabor Allocated to Mfg Div [A + C]	E Planned Reductions in CSS NonLabor re Mfg
1	Executive	-	263,581	59,042	59,042	-
2	Safety	-	59,703	13,373	13,373	(17,000)
3	Procurement	-	11,243	2,518	2,518	-
4	Finance	14,497	44,396	9,945	24,442	(3,262)
5	Treasury	(1,304)	(5,218)	(1,169)	(2,473)	-
6	Risk Mgmt	6,588	-	-	6,588	-
7	Int Audit	-	222,811	49,910	49,910	-
8	Human Resources	287,720		-	287,720	(81,456)
9	Info Services	331,801	126,475	28,330	360,131	(18,868)
10	Corp Affairs	20,944	234,569	52,543	73,487	(22,000)
11	Env Affairs	15,780	-	-	15,780	(8,711)
12	Legal	13,049	-	-	13,049	-
13	G.O. Security	8,229	22,386	5,014	13,243	-
14	G.O. Facility Maint.	128,459	349,472	78,282	206,741	-
15	Corp Depreciation	60,699	165,132	36,990	97,689	-
16	Corp Property Tax	11,947	32,503	7,281	19,228	-
17	Misc Manu. Costs	78,033	-	-	78,033	(78,033)
18	Corporate Insurance	-	545,863	122,273	122,273	-
19	Outside Prof Services	177,801	1,455,232	325,972	503,773	(1,006,781)
20	Cust Svcs	-	-	-	-	
21	Rates	-	-	-	-	
22	Marketing	-	-	-	-	(736)
23	"Treasury" CBP	-	-	-	-	
24	Community Investment	-	-	-	-	
25	External Comunication	-	-	-	-	
26	Total	1,154,243	3,528,148	790,304	1,944,547	(1,236,847)

note: column A represents nonlabor costs allocated specifically to Mfg division via cost drivers like # employees, # invoices, % of time estimates, # of PC's, # paychecks, etc.

Petitioner's Exhibit JRB-8
IURC Cause No. 43201

Summary of Pro Forma Impact of Disposition of the Manufacturing Division
on CSS Costs allocated to the Steam System

Line No.		A Labor	B Benefits	C Non-Labor	D Total
	CSS Costs Without Manufacturing:				
1	Steam	1,025,325	875,215	998,982	2,899,522
2	Total	13,732,339	10,408,539	18,615,699	42,756,577
3		7.5%	8.4%	5.4%	6.8%
	Test Year CSS Costs:				
4	Steam	965,620	773,823	951,162	2,690,605
5	Total	15,180,790	11,125,144	19,852,546	46,158,480
6		6.4%	7.0%	4.8%	5.8%
	Impact of Removal of Manufacturing:				
7	Steam	59,705	101,392	47,820	208,917
8	Total	(1,448,451)	(716,605)	(1,236,847)	(3,401,903)

BEFORE THE

INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE BOARD OF DIRECTORS FOR UTILITIES OF THE DEPARTMENT OF PUBLIC UTILITIES OF THE CITY OF INDIANAPOLIS, AS SUCCESSOR TRUSTEE OF A PUBLIC CHARITABLE TRUST, D/B/A CITIZENS THERMAL ENERGY FOR (1) AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR STEAM UTILITY SERVICE, (2) APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES APPLICABLE THERETO, (3) APPROVAL OF CHANGES TO ITS GENERAL TERMS AND CONDITIONS FOR STEAM SERVICE, (4) APPROVAL OF NEW DEPRECIATION ACCRUAL RATES, AND (5) APPROVAL FOR THE QUARTERLY FILING OF FUEL COST ADJUSTMENT APPLICATIONS.	)	**CAUSE NO. 43201**

DIRECT TESTIMONY AND EXHIBITS
of
MICHAEL D. STROHL

On
Behalf of
Petitioner

Citizens Thermal Energy

Petitioner's Exhibit MDS

INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME.

A. Michael D. Strohl.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Board of Directors for Utilities, d/b/a Citizens Gas & Coke Utility and d/b/a Citizens Thermal Energy ("Citizens" or "Petitioner"), 2020 North Meridian Street, Indianapolis, Indiana, as its Corporate Treasurer.

Q. HOW LONG HAVE YOU HELD THAT POSITION?

A. I have been in the position of Corporate Treasurer since October 1, 2003. I began my employment with Citizens Gas & Coke Utility ("Citizens Gas") in 2000 and have held various positions within the financial division of Citizens Gas.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I graduated from Illinois State University in 1987, with a Bachelor of Science Degree in Economics, and from Indiana University in 1997, with an MBA in Finance.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL BACKGROUND AND EXPERIENCE.

A. I have 16 years of experience working in capital markets and in corporate finance. Upon graduating from Illinois State University, I worked four years as an inventory control analyst for Avon Products, Inc. in Chicago, Illinois. In 1991, I joined City Securities Corporation in Indianapolis where I held a variety of capital markets and

investment banking positions, until leaving as the Vice President of Corporate Finance in 1999. I worked for nine months as Merger & Acquisition manager for Magnequench International in Anderson, Indiana where I was responsible for leading over $400 million in financing efforts as well as the acquisition of two European competitors. I have been employed at Citizens Gas since 2000 as its Director of Finance and since 2003 as Citizens' Corporate Treasurer.

I have been involved in various trade organizations throughout my career including the Indianapolis Society of Financial Analysts, the Indianapolis Bond Traders Club and the Venture Club of Indiana.

Q. WHAT ARE YOUR RESPONSIBILITIES AND DUTIES AS THE CORPORATE TREASURER FOR CITIZENS?

A. Primarily, I am responsible for all facets of cash management, capital management, banking structure, investment analysis and policy, capital structure and investor relations (e.g, dealing with bond holders). Since joining Citizens Gas, I have been responsible for creating and implementing a trust-wide investment policy, re-organizing the existing banking structure and relationships, debt issuance and capital markets activities, cash forecasting, portfolio management for non-regulated assets, capital structure analysis and management, gas price hedging, interest rate hedging and investor relations with financial stakeholders. Also, I have been involved in the development of the price volatility mitigation program for Citizens Gas.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes. I sponsored direct testimony on behalf of Citizens Gas in Cause No. 37399-GCA81 on the subject of the costs Citizens Gas incurs to administer its financial price volatility mitigation program. More recently, I sponsored direct testimony on behalf of Citizens Gas in Cause No. 42767 on the subject of working capital requirements.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. My testimony addresses Petitioner's debt service revenue requirements.

ANNUAL DEBT SERVICE REQUIREMENT

Q. PLEASE DESCRIBE THE LONG-TERM DEBT THAT APPEARS ON THE SEPTEMBER 30, 2006 BALANCE SHEET OF THE PETITIONER.

A. Please refer to pages 8-17 of Mr. Brehm's direct testimony for a complete overview of the capital structure of the Steam Division.

Q. MR. BREHM DISCUSSES TWO SERIES OF LONG-TERM BONDS ISSUED BY THE PETITIONER. PLEASE DESCRIBE THE SUBSTANTIVE TERMS OF EACH SERIES OF BONDS.

A. The City of Indianapolis, Indiana, Thermal Energy System Revenue Bonds, Series 2001 A, that Mr. Brehm discusses are long-term, tax-exempt, fixed-rate bonds. The bonds were issued on January 15, 2001, with a par amount of $115,110,000 and a final stated maturity of October 1, 2021. Upon the advice of Petitioner's financial advisors, the Series 2001 A bonds were issued in two tranches. Approximately

$108.5 million of bonds were issued in an institutional tranche for purchase by large institutional investors, such as mutual funds, banks, pension funds, etc. The second tranche was a retail tranche of approximately $6.6 million for purchase by individual investors. The Series 2001 A bonds were issued as interest-only for the first three years, with principal repayments commencing on October 1, 2004. The bonds were structured to amortize principal annually in an amount that, when combined with interest costs, would produce level debt service amounts at approximately $10.2 million per year for the fixed-rate notes. The Series 2001A bonds were issued at a total premium of $5,248,537, net of original issue discount, and an average coupon rate of 5.31%.

The City of Indianapolis, Indiana, Thermal Energy System Multi-Mode Revenue Bonds, Series 2001 B, that Mr. Brehm also discusses, were long-term, tax-exempt, variable rate bonds. Those bonds were issued on January 15, 2001, with a par amount of $48,775,000 and a final stated maturity of October 1, 2025. The bonds were issued at par and have no premium or discount. The interest rate on the Series 2001 B bonds is reset weekly and is determined through a weekly auction to bond investors. The interest rate is determined based on bids submitted to an auction agent. Generally speaking, the bonds trade very close to a municipal bond index known as the Bond Market Association Municipal Swap Index, which is commonly referred to as the BMA rate.

Q. ARE THE ABOVE-DESCRIBED BONDS SUBJECT TO ANY MORTGAGE LIENS OR FURTHER COLLATERALIZED BY PROPERTY OR EQUIPMENT?

A. No. The source of repayment for the required interest and principal payments are the Income and Revenues of the Thermal Energy System. The term "Income and Revenues" of the Thermal Energy System is defined in the Trust Indenture as all revenues and other income of the Thermal Energy System, including revenues from Thermal Contracts (unless designated as contributions in aid of construction and bond proceeds; but excluding (a) extraordinary items; (b) income on moneys or securities in the Thermal Energy System Construction Fund; and (c) income on Escrow Securities).

Q. ARE EITHER SERIES OF BONDS REDEEMABLE PRIOR TO THEIR FINAL STATED MATURITY?

A. Yes. The Series 2001A bonds are redeemable beginning October 1, 2011 for all bonds maturing on or after October 1, 2012. Between October 1, 2011 and September 30, 2012, the Series 2001 A bonds are redeemable at 101% of their outstanding amount, plus accrued interest. After September 30, 2012, the bonds are redeemable at 100% of their outstanding amount, plus accrued interest.

The Series 2001B bonds are redeemable prior to their final stated maturity. If the bonds are in a daily rate period mode, weekly rate period mode, or flexible rate

period mode, they may be redeemed at 100% of their outstanding principal amount plus accrued interest on the day next succeeding the last day of such rate period. If the bonds are in an auction rate period mode they may be redeemed at 100% of their outstanding principal amount, plus accrued interest on the business day immediately succeeding any auction date. If the bonds are in a term rate period, they may be redeemed at various premiums to the outstanding principal amount ranging from 102% of outstanding principal, plus accrued interest if the term rate period is more than 15 years, down to 100% of outstanding principal plus accrued interest if the term rate period is 3 years or less.

Q. ARE THE CITIZENS THERMAL ENERGY SYSTEM BONDS SUBJECT TO ANY RESTRICTIVE COVENANTS UNDER ITS TRUST INDENTURE?

A. Yes. There are several covenants in the Trust Indenture that are common to municipal bond issues, such as a covenant to maintain property, to pay taxes when due, maintain books and records, etc. There is one financial covenant in the Trust Indenture that requires the Thermal Energy System to have sufficient Income and Revenues to pay (i) operating expenses of the Thermal Energy System, (ii) an amount equal to the Aggregate Bond Service Requirement on all bonds, and (iii) the amount, if any, to be paid from the Thermal Energy System General Fund during the fiscal year into the Thermal Energy System Reserve Fund during the fiscal year, relating to all bonds.

Q. IS CITIZENS IN COMPLIANCE WITH THIS PARTICULAR BOND COVENANT?

A. Yes. During the test year, the coverage ratio for the entire Thermal Energy System was 2.35 times, as contrasted with the Bond Indenture requirement of 1.0 times. However, Mr. Brehm points out in his testimony that the Steam System's stand alone coverage ratio is currently less than 1.0, which means at present rates Petitioner's Steam System revenues are inadequate to allow it to service its share of total Thermal Energy debt.

Q. PLEASE DESCRIBE PETITIONER'S EXHIBITS MDS-1 AND MDS-2.

A. Exhibit MDS-1 determines the pro forma debt service and Exhibit MDS-2 calculates the total pro forma interest income to be included in Petitioner's revenue requirements in this Cause.

Q. PLEASE EXPLAIN HOW YOU CALCULATED PETITIONER'S TOTAL PRO FORMA DEBT SERVICE REVENUE REQUIREMENTS ON PETITIONER'S EXHIBIT MDS-1.

A. I computed the pro forma interest payments and principal payments on the Steam System's portion of the Series 2001A and Series 2001B bonds and added to that amount the Steam System's share of annual bond financing expenses. The Steam System's share of debt service on the Series 2001 A bonds is a fixed amount. Earlier in my testimony I noted that the Series 2001A bonds were structured to

provide Petitioner with level debt service at approximately $10.2 million per year. Mr. Brehm establishes that 43.4% of the total Thermal debt is allocable to the Steam System. Consequently, the Steam System's portion of annual debt service on the Series 2001 A bonds will be approximately $4.4 million each year.

The Series 2001B bonds are variable rate bonds. The interest rate on the Series 2001B bonds is determined weekly and fluctuates based on changes in the general level of interest rates. Specifically, the rate fluctuates with short-term municipal bond rates. During the test year, the average annualized interest rate on the Series 2001B bonds was 3.21%. However, the Federal Reserve Bank has raised short-term interest rates by 100 basis points, or 1%, from 4.25% in January 2006 to 5.25% in January 2007. This increase in short-term rates affects all variable rate instruments in the capital markets since the benchmark from which all securities are priced is the government risk-free rate, which for short-term variable rate securities is generally considered to be the Federal Funds Rate. As I mentioned earlier, Citizens Thermal Energy's auction rate notes generally trade very close to the BMA rate. The BMA rate is published weekly by the Bond Market Association but is not quoted on a going forward basis. Historically, a good proxy for determining the BMA rate on a going forward basis is a ratio of approximately 70% of the 1-month London Interbank Offered Rate ("Libor"). The pro forma rate I used for calculating the Series 2001B interest expense was 3.66%, which is equal to 70% of the 1-month Libor rate on the 1

year forward yield curve as of March 19, 2007. Currently, the Series 2001B interest rate for the week ended March 20, 2007 is 3.55%. Multiplying the pro forma interest rate of 3.66% times the total principal amount of $48,775,000 times the Steam System share of 43.41% results in a pro forma interest expense on the 2001B bonds of $774,940. Additionally, the Series 2001B bonds do not begin amortizing principal until 2021. Therefore, there are no principal payments included in the pro forma debt service calculation in this proceeding.

The pro forma bond financing expenses reflect the Steam System's share of annual charges for rating agency fees, broker-dealer fees, and bond trustee administration fees.

The total pro forma debt service included in the revenue requirement in this Cause is $5,267,722, as calculated in column B, line 9 of Petitioner's Exhibit MDS-1.

Q. PLEASE DESCRIBE PETITIONER'S EXHIBIT MDS-2.

A. Exhibit MDS-2 calculates pro forma interest income. Petitioner typically has cash balances invested in money market securities and fixed-income securities, and generally has a small amount of cash on deposit in bank accounts for operating cash needs. To calculate pro forma interest income, I began with cash available for investment from line 4. Please refer to Petitioner's witness Brehm's testimony for an explanation of how the cash available for investment was determined. I then allocated that cash balance among money market securities, fixed-income securities

and bank balances in the same proportion that they were invested at the end of the test year, which was 69.75%, 19.55% and 10.7%, respectively. I then multiplied the respective balance of each asset class times the projected interest rate for the pro forma year ended September 30, 2007. The resulting pro forma amount of interest income is set forth on line 5, column F of Petitioner's Exhibit MDS-2.

CONCLUSION

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

VERIFICATION

STATE OF INDIANA)
) ss:
COUNTY OF MARION)

The undersigned, Michael D. Strohl, under penalties of perjury and being first duly sworn on his oath, says that he is Corporate Treasurer for Citizens Thermal Energy; that he caused to be prepared and read the foregoing Direct Testimony; and that the representations set forth therein are true and correct to the best of his knowledge, information and belief.

Michael D. Strohl

By: Michael D. Strohl
Corporate Treasurer
Citizens Thermal Energy

Subscribed and sworn to before me, a Notary Public, this 30 day of March, 2007.

Valorie L Dalton
Signature

Valorie L. Dalton
Printed Name

My Commission Expires: 2/11/09

My County of Residence: Marion

Citizens Thermal Energy System
IURC Cause No. 43201
Petitioners Exhibit MDS-1

CITIZENS THERMAL ENERGY
STEAM SYSTEM
Pro Forma Total Debt Service Requirements

Steam Allocation 43.41%

Line No.		(A) Test Year Actual 2006	(B) Pro Forma 2007
	Interest Payments:		
1	Series A 2001 Revenue Bond	$ 2,441,818	$ 2,345,242
2	Series B 2001 Revenue Bond	680,484	774,940
3	**Total**	**$ 3,122,302**	**$ 3,120,182**
4	Bond Financing Expenses	70,371	70,371
5	**Total Interest Payments**	**$ 3,192,673**	**$ 3,190,553**
	Principal Repayments:		
6	Series A 2001 Revenue Bond	$ 2,001,201	$ 2,077,169
7	Series B 2001 Revenue Bond	-	-
8	**Total Principal Repayments**	**$ 2,001,201**	**$ 2,077,169**
9	**Total Debt Service Requirements**	**$ 5,193,874**	**$ 5,267,722**
		3.21%	3.66%

Citizens Thermal Energy System
IURC Cause No. 43201
Petitioners Exhibit MDS-2

CITIZENS THERMAL ENERGY
STEAM SYSTEM
Pro Forma Interest Income

Line	A	B	C	D	E	F
1	**9/30/06 Cash Balance (excluding CAPX Fund)**		$ 14,596,985			
2	**Less: Cash needed for MACT**		(5,922,024)	Source: Exhibit JRB-2(a) line 15		
3	**Less: Cash needed for operating deficit**		(6,659,432)	Source: Exhibit JRB-2(a) line 16		
4	**Total Cash available for investment**		$ 2,015,529			

	Interest Income	Money Market		Fixed Income		Bank		Bond Principal/ Interest Funds[4]	Total
5	2007	$ 63,528	69.75%	$ 18,669	19.55%	$ -	10.70%	$ 67,457	$ 149,654

	Interest Rates	Money Market[1]	Fixed Income[2]	Bank[3]
6	2007	4.5189%	4.7379%	0.0000%

[1] Projected interest rates for Money Market Securities derived from the Bloomberg 1 year forward yield curve for US Treasury Strips as of 03/19/07

[2] Projected interest rates for Fixed Income Securities taken from the Bloomberg 1 year forward yield curves for US Government Agency Securities as of 03/19/07

[3] Cash in bank accounts do not receive interest on outstanding balances

[4] Bond Principal/Interest funds reflect cash balances deposited with the bond trustees prior to payment to bondholders. Steam's portion of these earnings has historically averaged $67,000.